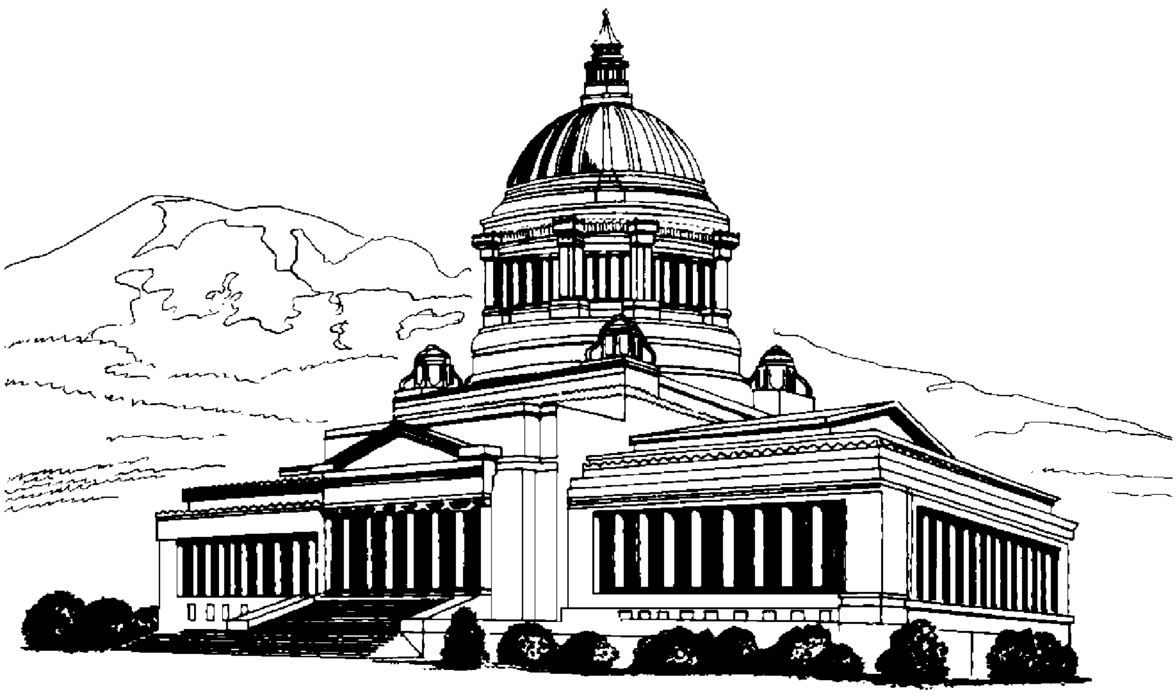
WASHINGTON STATE PROPERTY TAX MANUAL



Senate Ways & Means Committee
November 7, 1996

FOREWORD

This manual is a compilation of Washington state property tax information intended to serve as a reference document for data on the various legal, procedural, and policy aspects of the property tax system.

Information from various sources was used in compiling this report, including 1996 Property Tax Statistics, 1995 Tax Statistics, 1993 Comparative State and Local Taxes, and 1996 Tax Exemptions, all published by the Department of Revenue, as well as the 1995 "Local Regular Property Taxes" study from the House Office of Program Research.

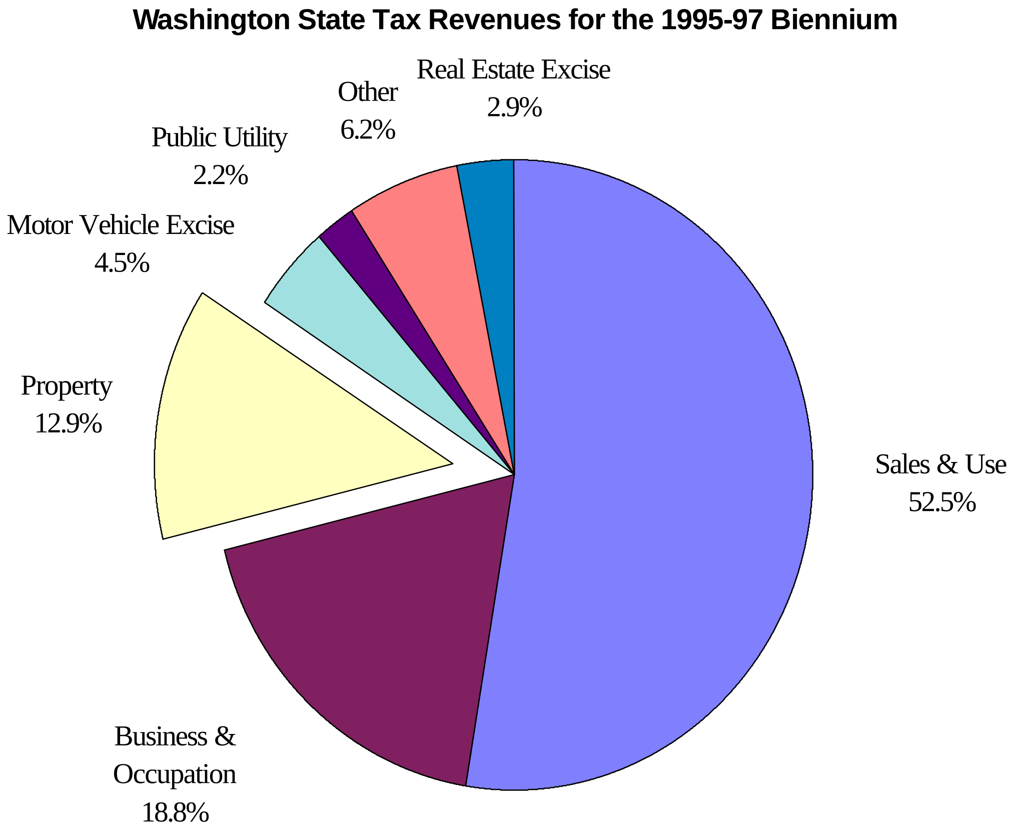
The audience for this manual is anticipated to be persons with some working knowledge of the property tax system and can include members of the Legislature and legislative staff, the Governor's office, executive branch agencies, County Assessors, citizens, businesses, and the media. Additional copies may be obtained from the Senate Ways and Means Committee or on the Internet at **http://www.leg.wa.gov/www/senate/swm/welcome.htm.**

Any questions concerning this report should be addressed to the staff of the Senate Ways and Means Committee, 300 John A. Cherberg Building, Olympia, Washington 98504. Telephone: (360) 786-7715.

TABLE OF CONTENTS

I. OVERVIEW OF PROPERTY TAXES IN WASHINGTON STATE

The property tax is the single largest source of revenue for local governments, generating about $6.2 billion for local governments for the 1995-97 biennium. The property tax is the third largest source of revenue to the state general fund and will generate about $2.2 billion for the state for the 1995-97 biennium. This comprises 12.9 percent of general fund tax revenues as shown by the following chart.



A. What property is taxable?

The property tax is applied annually to the assessed value of all property except that which is specifically exempted by law. Taxable property includes both real property and personal property. Real property is land and the buildings, structures, or improvements that are affixed to the land. Personal property includes all property that is not real property. Because the Legislature has provided tax exemptions for motor vehicles and household goods and personal effects, taxable personal property is personal property used in a trade or business. Additionally, the first $3,000 of taxable personal property for heads of households is exempt. This reduces the personal property tax liability of non-corporate businesses which are subject to personal property tax on business equipment and supplies. Some intangible personal property, such as stocks, bonds, and bank accounts, are exempt from property tax. See Exemptions for Intangible Property, page 31.

B. Who determines the value of property?

Real property lying wholly within individual county boundaries is valued and assessed by the County Assessor. Inter-county, interstate, and foreign utility and transportation companies are valued and assessed by the Department of Revenue. Property assessed by the Department of Revenue is referred to as state-assessed or centrally assessed property. The amount and value of personal property is reported by April 30th of each year to the County Assessor by persons with taxable personal property.

C. What is the "assessed" value of property?

The property tax is imposed on the assessed value of property. Property is assessed at 100 percent of its market value which is the amount of money a willing buyer would pay a willing seller. Certain qualified lands (agricultural, open space, and timber lands) may be valued and assessed on the basis of their current use, which may be less than their highest and best use. Application must be made for current use classification.

D. How is the amount of tax levied by a taxing district determined?

A taxing district levies a property tax in the amount needed to fund its budget for the following year. Annually, taxing districts, other than the state, must hold a public hearing on revenue sources for the following year. The hearing must include consideration of possible increases in property tax revenues. By November 1st of each year, the amount of taxes to be levied by taxing districts are certified to the County Assessor who computes the tax rate necessary to raise that amount of revenue. The County Assessor calculates the tax rate necessary by dividing the total levy amount by the amount of taxable property in the district. This number is expressed in terms of a dollar rate per $1,000 of valuation. For example, a rate of $0.00025 is expressed as 25¢ per $1,000 of assessed value. For the state levy (which is dedicated to the support of the common schools), the state Department of Revenue determines the amount of tax to be levied, apportions the tax to the various counties, and certifies the tax to the county assessors.

E. What are "regular" and "excess" levies?

The state Constitution limits the aggregate property tax that can be levied without a vote of the people to a maximum of 1 percent of the true and fair value of the property (or $10.00 per $1,000 of value). Levies under the 1 percent limit are termed "regular" levies. This limit applies to the total tax on any individual parcel of property, but this limit does not include regular levies by port districts and public utility districts. Port district and public utility district regular levies are each limited separately by statute to 45¢ per $1,000 of assessed value.

Levies in excess of the 1 percent limit require voter approval and are termed "excess" or "special" levies. These levies are approved in terms of total dollars and are generally for one year only but can be for two to six years with respect to school districts and as many as 30 years with respect to capital or "bond retirement" levies.

F. What are the limits on the regular levies of taxing districts?

The regular levies of individual taxing districts are subject to 1) a statutory limit on the maximum rate that can be imposed; 2) a limit on the total revenue that may be collected by the taxing district, known as the 106 percent limit; and 3) an aggregate limit on the total combined rate imposed by all taxing districts other than the state.

1. Maximum Rate Limit

The maximum rates are expressed in terms of a dollar value per $1,000 of assessed value. For example, the statutory rate limit for the state portion of the property tax levy is $3.60 per $1,000 of assessed value (adjusted to market value), for counties it is $1.80 per $1,000 of assessed value, and for cities and towns it is $3.375 per $1,000 of assessed value.

2. 106 Percent Limit

Each year, the regular property tax levies of taxing districts are limited to 106 percent of the highest levy in the three preceding years plus the amount of revenue that new construction, improvements to property, and changes in state-assessed property would have generated at the preceding year's tax rate. The limit does not apply to excess (voter-approved) levies such as local school maintenance and operation levies and levies to retire bond issues.

Levies in excess of the 106 percent limit require voter approval. If such a levy is approved, it becomes the base for calculation of future levies, unless it is approved for a limited time or purpose.

3. Aggregate $5.90 Rate Limit

The total combined regular property tax levies of all taxing districts, other than the state, port districts, and public utility districts, are subject to an aggregate limit of $5.90 per $1,000 of assessed value. If the cumulative total of these levies exceeds the $5.90 limit, the assessor reduces the levy rates according to a statutory formula.

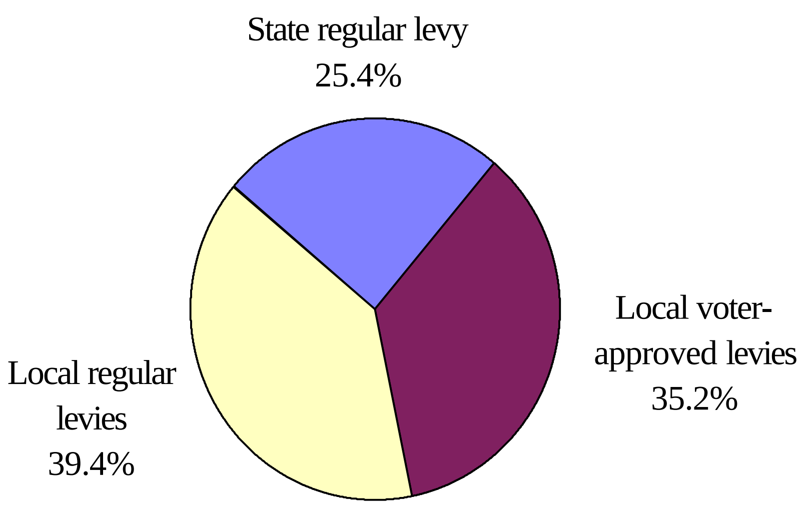
G. Why does the state levy rate vary by county?

The state Constitution requires all taxes on real estate to be uniform within a taxing district. This requires all taxes imposed by any taxing district to be the same on property of the same market value. Since the state is a taxing district with respect to the state property tax levy, the state property tax must be the same throughout the state on property of the same market value. Because the various assessment practices of county assessors do not result in all property being assessed at 100 percent of market value, the state levy is "equalized" on a county by county basis to account for this. As a result, the state levy rate is adjusted for each county. (See Equalization of Assessments, page 8.) For 1996 taxes, the state tax rate was $3.25 while the average equalized state tax rate was $3.51.

H. How is the total levy rate calculated?

The equalized state levy rate is added to the local rates to determine the total regular levy rate. If the rate exceeds $10, levy rates are reduced according to a statutory formula. Once the regular property tax levy rate is determined, the County Assessor determines the excess levy rate necessary to raise the amount of money approved by the voters in that year and in previous years. The excess levy rate is then added to the regular levy rates to determine the total tax rate. The statewide average tax rate for 1996 taxes was $13.82 per $1,000 of assessed value. Of this amount, $3.51 was the state regular levy, $5.44 was for local regular levies, and $4.87 was for voter-approved excess levies, as shown by the following chart.

Components of the 1996 Statewide Average Tax Levy



I. How is the tax on an individual parcel of property calculated?

The tax due on an individual parcel of property is the total tax rate multiplied by the assessed value of the property. For a parcel of property assessed at $100,000, the tax would be determined as follows:

Tax Rate (per $1,000)	/	1,000	x	Value	=	Tax Due
$13.82	/	1,000	x	$100,000	=	$1,382

J. How are property taxes collected?

Property taxes are collected by the treasurer in the county in which the property is located. The County Treasurer is required to notify the taxpayer of the amount of tax owed. The notice must state the value of the real and personal property, the amount of current and delinquent property tax, and the name and amount of tax for each taxing district levying a tax. Excess levies must be separately stated on tax notices. The County Treasurer sends the tax bill to the "taxpayer" listed on the tax rolls. In cases where the property owner has provided that taxes are to be paid from a reserve account kept by the lending institution, the "taxpayer" is the lending institution. The County Treasurer mails the property tax bills to taxpayers after February 15th.

K. When are property taxes due?

Property taxes are due on April 30 each year. If one half the tax is paid by April 30, then the other half is due on October 31. However, if the first half is not paid on time, the entire tax is delinquent. If the tax is below $50, then all the tax must be paid by April 30.

L. What are the penalties for late payment?

Delinquent property taxes are subject to interest and penalties. Interest is charged at the rate of 12 percent per year (1 percent per month) from the date of delinquency. A penalty of 3 percent is imposed on the amount of tax delinquent on June 1st, and an additional penalty of 8 percent is imposed on the amount of tax delinquent on December 1st.

M. When are taxes distributed to taxing districts?

Taxes collected by the County Treasurer are distributed monthly to the taxing districts levying the tax. Taxes collected under the state levy are paid monthly by the county treasurers to the State Treasurer who deposits the moneys in the state general fund for the support of the common schools.

For a history of the major changes to the property tax, see Appendix A, page 34.

II. VALUATION AND ASSESSMENT

A. General

For property tax purposes, real property is valued at its true and fair value, which is its market value. This value is determined by the market based on the highest and best use of the property. The highest and best use of the property is the most profitable use of the property, which may not necessarily be the current use of the property. It is the use which will yield the highest return on the owner's investment. The highest and best use value is sometimes higher than the current use value. The state Constitution authorizes and current law provides that the true and fair value of farm and agricultural land, standing timber and timberlands, and open space lands may be based on their current use rather than their highest and best use. Valuation at a lower value will reduce the amount of tax on the property.

Real property lying wholly within individual county boundaries is valued and assessed by the County Assessor. Inter-county, interstate, and foreign utility and transportation companies are valued and assessed by the Department of Revenue (state-assessed property). The value of taxable personal property is reported each year by taxpayers to the County Assessor.

There are three common approaches used in valuing real property: the sales approach (comparable sales); the cost approach (replacement cost); and the income approach (capitalized income potential). One, two, or all three methods may be applied to a given parcel. The sales approach is mainly used for residences, the cost approach is used for manufacturing and similar facilities, and the income approach is used principally for commercial property, including apartment houses.

Property taxes are imposed on the assessed value of property. Property is assessed at its true and fair value, unless the property qualifies under a current use valuation program, and true and fair value has been interpreted to mean market value. For tax purposes, all property except new construction is assessed on its value on January 1st of the assessment year and is listed on the tax rolls by May 31st. New construction is assessed on its value on July 31st of the assessment year and is listed on the tax rolls by August 31st. Because various properties are appraised at different times during the year, county assessors use formulas to adjust the appraised values to the valuation date. These values are used for determining property taxes to be collected in the following year.

Notices of valuation changes are mailed to taxpayers. A bank or other lending institution that pays the property tax on behalf of the property owner is required to provide the owner's name and address to the assessor upon the assessor's request. The notice is required to contain a statement of the previous and the new values, with land and improvements listed separately.

County assessors revalue property periodically on a regular revaluation cycle. The length of the revaluation cycle varies by county. The most common length is four years, which is the maximum allowed by statute. Of the thirty-nine counties, nineteen counties revalue every four years. One county, San Juan, revalues every three years. Two counties, Douglas and Franklin, revalue every two years. The remaining seventeen counties revalue every year. The following table specifies the revaluation cycles for the various counties for the 1996 assessment year.

COUNTY REVALUATION CYCLES 1996 Assessment Year		
ANNUAL REVALUATION	**2-YEAR**	**4-YEAR**
Adams	Douglas	Asotin
Benton	Franklin	Chelan
Clallam		Columbia
Clark		Ferry
Cowlitz	**3-YEAR**	Grant
Garfield (4 year inspection)	San Juan	Grays Harbor
Island		Jefferson
King		Kittitas
Kitsap		Klickitat
Lincoln		Lewis
Pierce		Mason
Skagit		Okanogan
Skamania (4 year inspection)		Pacific
Spokane		Pend Oreille
Thurston		Snohomish
Whitman		Stevens
Yakima		Wahkiakum
		Walla Walla
		Whatcom
Source: Department of Revenue		

If a county's revaluation cycle is longer than two years, an equal portion of the county must be revalued during each year of the cycle. Values of individual parcels of property are not changed during the intervening years of the revaluation cycle. As a result, the change in value for an individual parcel of property follows a stair-step pattern. For example, in a four-year revaluation cycle there is no change in value for a parcel of property for three years. In the fourth year, there is a change in value representing four years of value growth.

Counties on revaluation cycles longer than one year must physically inspect each parcel of property at the time it is revalued. If a county revalues property annually, physical inspection of each parcel of property is required only once every six years, and values are adjusted annually based on statistical market value data.

A combination of delayed value changes due to revaluation cycles and volatile real estate markets can generate substantial changes in assessed values from one year to the next. In addition, the revaluation of property can cause taxes to shift among taxpayers. For example, if a county revalues one-fourth of its property every year (4-year cycle), taxes will shift to the property that was most recently revalued because the value of that parcel will represent a greater percentage of the tax base (in a rising market).

B. Equalization of Assessments

As mentioned previously, the Constitution requires all taxes on real estate to be uniform within a taxing district. This requires all taxes imposed by any taxing district to be the same on property of the same market value. Since the state is a taxing district with respect to the state property tax levy, the state property tax must be the same throughout the state on property of the same market value. Because the various assessment practices of county assessors do not result in all property being assessed at 100 percent of market value, the state levy is "equalized" on a county by county basis to provide for uniform taxation throughout the state.

By the first Monday in September of each year, the Department of Revenue compares the assessed value of selected properties in the counties to the fair market value of those properties, as determined by the Department from real estate excise tax affidavits, to determine the real property ratio. For example, if a parcel of property sold for $100,000 (after deducting an amount for any personal property that may have been included in the sale) and its assessed value is $90,000, the ratio of assessed value to market value would be 90 percent, determined as follows:

Assessed Value	/	Market Value	=	Assessment Ratio
$90,000	/	$100,000	=	90%

The Department also determines the ratio for taxable personal property. The combination of these two ratios is known as the indicated ratio for the county. For 1996 taxes, the average indicated ratio was 88.2 percent.

During the months of September and October, the Department is required to equalize the values of the counties so that each county pays its proportion of state property taxes according to the ratio the valuation of the property in each county bears to the total valuation of all property in the state. In equalizing values, the Department is required to raise or lower the valuation of real and personal property in the county so that the value is equal, as far as possible, to the true and fair value of the property on January 1st of the assessment year. Values are equalized using the indicated ratios computed by the Department.

Within three days after the equalization results are certified, the Department transmits a record of the proceedings to each county assessor and specifies the dollar amount of state taxes to be levied and *collected from that county. Upon receipt, the County Assessor determines the required tax rate to be levied on the assessed value in the county in order to generate the required dollar amount.

C. Current Use Programs

The state Constitution authorizes agricultural, timber, and open space land to be valued on the basis of their current use rather than fair market value. Current use valuation reduces the taxable value against which taxing districts levy their taxes. When values are lowered, the tax rate of taxing districts that are not levying at their maximum statutory rate increases to compensate for the lower value. Because of the higher rate, taxpayers who do not benefit from the valuation reduction pay a higher tax. This higher tax is a shift of tax from the property valued at current use to property valued at highest and best use. To the extent that the tax rate of a taxing district is already at its statutory maximum and therefore cannot increase to compensate for the loss in value, the taxing district collects less revenue than it otherwise would have generated.

Two programs currently implement this constitutional exception to fair market value: the "open space" program and the "forest land" program. There are three categories of land under the open space program: 1) open space lands, 2) farm and agricultural lands, and 3) timber lands. There are two categories of land under the forest land program: classified and designated forest land. It should be noted that standing timber is generally exempt from property taxes and is instead subject to a yield tax on harvest.

A brief summary of the two current use programs follows. For a comprehensive discussion of the current use programs, see Appendix B, page 36.

1. Open Space Program

Open space land is any land designated as such by an official comprehensive land use plan and any land area, the preservation of which in its present use would:

- Conserve and enhance natural or scenic resources;
- Protect streams or water supply;
- Promote conservation of soils, wetlands, beaches, or tidal marshes;
- Enhance the value to the public of abutting or neighboring parks, forests, wildlife preserves, nature reservations or sanctuaries, or other open space;
- Enhance recreation opportunities;
- Preserve historic sites;
- Preserve visual quality along highway, road, and street corridors or scenic vistas; or
- Retain in its natural state tracts of land not less than one acre situated in an urban area and open to public use on such conditions as may be reasonably required by the legislative body granting the open space classification.

Open space land is valued based on the use to which the property is currently applied rather than other potential uses. The value must be at least the minimum value per acre of classified farm and agricultural land.

Farm and agricultural lands must be devoted primarily to commercial agricultural purposes. To qualify for classification as farm and agricultural land, the land must meet income tests for 3 of the previous 5 years. The value for farm and agricultural land is determined by discounting the "net cash rental" of comparable farm lands growing crops typical to the area.

Timber land is land of 5 or more acres devoted primarily to the growing and harvesting of timber. Timber land is valued under the forest land program (see below) and is based on the value of the bare land for growing and harvesting timber.

Property may be removed from open space classification by the owner giving notice to withdraw. Land is removed from open space classification by the assessor if it no longer is used for the purpose under which it was granted open space classification.

When property is removed from open space classification, back taxes equal to the tax benefit received over the most recent seven years, plus interest, must be paid. Sale or transfer to a new owner triggers removal from the open space program unless the transfer occurs due to inheritance. Back taxes must be paid unless the new owner signs an agreement to continue in the program.

2. Forest Land Program

Land which has no higher and better use than growing and harvesting timber may be classified as forest land by the County Assessor. Land which is used to grow and harvest timber but which is more valuable for other uses may be designated as forest land by the assessor upon application to the County Assessor by the landowner. To qualify for either, the land must be 20 acres or more and be used primarily for growing and harvesting timber. The valuation of classified and designated forest land is set by statute and is based on the value of the bare land for growing and harvesting timber. The values vary based on the grade and operability of the land and are adjusted annually by the Department of Revenue. For 1994, the values ranged from a low of $17 per acre to a high of $201 per acre.

Land is removed from classification or designation at the request of the owner or by sale or transfer to an ownership making the land exempt from tax. The county assessor may remove classified land from classification by a determination that the land is no longer primarily used for growing and harvesting timber or that a better use exists for the land than growing and harvesting timber.

Upon removal from classification, both classified and designated forest land may be subject to a compensating tax equal to the tax benefit received in the most recent year multiplied by the number of years the land was classified or designated, not to exceed ten.

III. UNIFORMITY

Article 7, section 1 of the state Constitution provides that all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax and all real estate shall constitute one class. This means that taxes must be the same on property of the same market value. Tax uniformity requires both an equal tax rate and equality in valuing the property taxed.

To achieve uniform taxation in a district, the assessment of property must also be uniform. Taxes will not be uniform if property is assessed at different levels. Thus, if two pieces of property have a fair market value of $100,000 and one is assessed at 100 percent of market value ($100,000) and the other is assessed at 50 percent of market value ($50,000), the resulting taxes will not be uniform. The property assessed at 100 percent of market value will bear twice the tax of the property assessed at 50 percent of market value (e.g., $100,000 x 1% tax rate = $1,000 tax; $50,000 x 1% tax rate = $500 tax).

Because of the difficulty for county assessors to value all of the property in the county every year, some assessors revalue only part of the county every year. The most common revaluation cycle is the four-year cycle under which one-fourth of the properties in the county are revalued every year. If the assessor revalues less than all of the county in a year, it will have an effect on uniformity. Many of the legal challenges under the uniformity clause have been to the revaluation cycle used by county assessors. However, the state Supreme Court has sustained the four-year revaluation cycle against a uniformity challenge under Article 7, section 1 if it is administered in a systematic and nondiscriminatory manner.

In *Sator v. Department of Revenue*, 89 Wn. 2d 338 (1977), the court, in rejecting a challenge to the four-year revaluation cycle, stated that incidental inequalities may result from the 4-year revaluation cycle, but it does not violate the uniformity clause because it is conducted in an orderly manner and pursuant to a regular plan, and it is not done in an arbitrary, capricious, or intentionally discriminatory manner.

Also, the court in *Sator* stated that there is nothing in the Constitution that requires each class of property, real and personal, to be assessed at 100 percent of true or fair value. The only requirement is that each person within the class be treated uniformly. Due process and equal protection require that classifications for purposes of taxation have a reasonable basis and not be arbitrary and capricious.

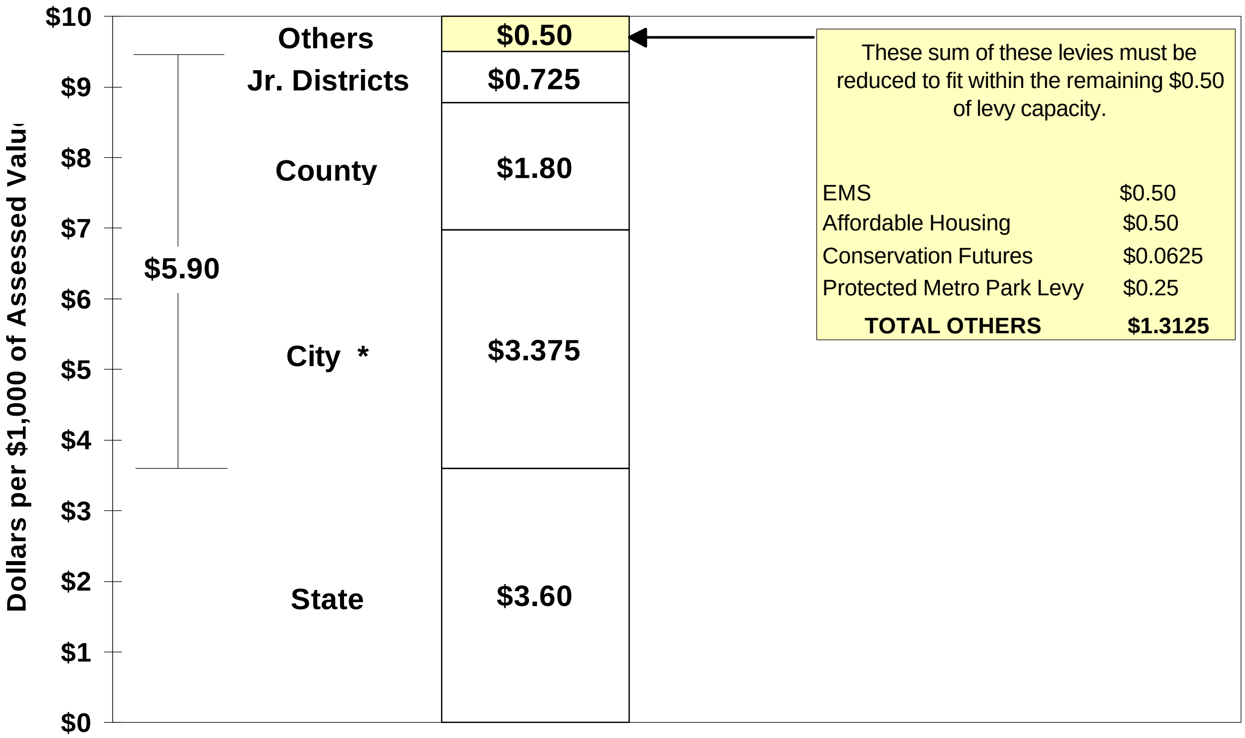
For a legal history of the requirement for uniformity of assessments, see Appendix C, page 41.

IV. 1 PERCENT LIMIT

Article 7, section 2 of the state Constitution limits the amount of property taxes that may be imposed on an individual parcel of property without voter approval to 1 percent of its true and fair value, or $10 per $1,000 of value. Taxes imposed under the 1 percent limit are termed "regular" levies.

The limitation on the cumulative rate of regular property taxes is restricted even further by statute. The following table shows the authorized levies under the 1 percent limit.

Maximum 1996 Regular Property Tax Levy Rates



* The maximum authorized tax rate for cities is $3.60 in a city that had a fire department before the Law Enforcement Officers and Fire Fighters (LEOFF) pension system was established and in cities that have been annexed by a library district or a fire district. In those cities, only 50 cents remains for junior taxing districts to share rather than 72.5 cents. In unincorporated areas, there is no city levy but a county road levy of $2.25 is authorized. In these areas, $1.85 remains for junior taxing districts to share rather than 72.5 cents.

The state levy is limited to $3.60 per $1,000 of assessed value for the support of the common schools, equalized to reflect assessment at less than market value. (See Equalization of Assessments, page 8.) The levies by the cities, counties, road districts, and junior taxing districts are limited to $5.90 per $1,000 of assessed value. If the combined rates of these districts exceed $5.90, the rates of these taxing districts are reduced according to statutorily set priorities until the combined rate is within the $5.90 rate limit. The following table specifies the proration priorities under the $5.90 limit.

1996 PROPERTY TAX PRORATION ORDER - $5.90 LIMIT		
	TAXING DISTRICT[1]	**COMMENTS**
FIRST	Park & Recreation Service Area Park & Recreation District Cultural Arts, Stadium District	60¢ 6-year voter-approved regular 60¢ 6-year voter-approved regular 25¢ 6-year voter-approved regular
SECOND	Flood Control Zone District	50¢
THIRD	Public Hospital (Last 25¢) Unprotected Metropolitan Park (25¢) Cemetery (11.25¢) All other junior districts	75¢ total authorized 75¢ total authorized
FOURTH	Fire District (2nd/3rd 50¢)	$1.50 total authorized
FIFTH	Fire District (1st 50¢) Library Metropolitan Park (1st 50¢) Public hospital (1st 50¢)	$1.50 total authorized 50¢ 75¢ total authorized 75¢ total authorized
SIXTH	County County road City	$1.80 $2.25 $3.375
[1] **These categories are listed in order of reduction. The first category is the lowest priority for levies. Districts in a category are reduced pro rata.**		

Total state and local levies are limited to $9.50. Outside this $9.50 statutory rate limit but subject to the 1 percent (or $10 per $1,000 of assessed value) limit are: 1) voter-approved regular property taxes for up to six years of up to 50 cents per $1,000 of assessed valuation for emergency medical service (EMS) purposes by a number of different taxing districts; 2) regular property taxes of up to 6.25 cents per $1,000 of assessed valuation by counties to acquire conservation futures; 3) voter-approved regular property taxes for up to ten years of up to 50 cents per $1,000 of assessed valuation for affordable housing; and 4) 25 cents of a metropolitan park district levy (in a district with a population of over 150,000) that has been approved by the voters. These additional levies total $1.3125.

As can be seen from the chart on page 12, if all of these taxing districts imposed the levies at their maximum rates, the total rate would exceed $10 per $1,000 of assessed value. If the combined rate of all levies that are imposed exceeds $10 per $1,000 of assessed value, the levies over the $9.50 limit are reduced first. If the levies are still over $10 (because of an equalized state rate over $3.60), the levies subject to the $5.90 limit are reduced according to statutorily set priorities. The following table shows these priorities.

1996 PROPERTY TAX PRORATION ORDER - 1% LIMIT (After making the 106% calculation and prorating under the $5.90 limit)		
	TAXING DISTRICT[1]	**COMMENTS**
FIRST	Protected Metropolitan Park	25¢ not subject to $5.90 limit for 6 years with voter approval
SECOND	Conservation futures Affordable housing Emergency medical services (over 30¢)	6.25¢ regular 50¢ 10-year voter-approved regular 50¢ 6-year voter-approved regular total
THIRD	Emergency medical services	1st 30¢
FOURTH	Park & Recreation Service Area Park & Recreation District Cultural Arts, Stadium District	60¢ 6-year voter-approved regular 60¢ 6-year voter-approved regular 25¢ 6-year voter-approved regular
FIFTH	Flood Control Zone District	50¢
SIXTH	Public Hospital (25¢) Unprotected Metropolitan Park (25¢) Cemetery (11.25¢) All other junior districts except those in the Seventh & Eight priorities	
SEVENTH	Fire District (2nd/3rd 50¢)	$1.50 total authorized
EIGHTH	Fire District (1st 50¢) Library Metropolitan Park (1st 50¢) Public hospital (1st 50¢)	$1.50 total authorized 50¢ 75¢ total authorized 75¢ total authorized
NINTH	County County road City	$1.80 $2.25 $3.375
TENTH	State school levy	Local rate
[1] **These categories are listed in order of reduction. The first category is the lowest priority for levies. Districts in a category are reduced pro rata.**		

The 1 percent limit may be exceeded if approved by 60 percent of the voters voting on the proposition provided the "yes" vote at least equals 24 percent of the number of votes cast in the last general election.

For levies for capital purposes, the number of voters voting must at least equal 40 percent of the number of voters voting in the taxing district in the last general election. Voter-approved property taxes are termed "excess" or "special" levies. These levies are approved in terms of total dollars and are generally for one year only but can be for two to six years with respect to school districts and as many as 30 years with respect to bond retirement levies. Each year, the assessor determines the rate necessary to raise the amount of money approved in that year and in previous years and adds that rate to the regular levy rate. For 1996 taxes, the total statewide average property tax rate was $13.82 per $1,000 of assessed valuation.

V. 106 PERCENT LIMIT

In 1971, the Legislature imposed a statutory lid on regular property tax levy increases. Under this lid, regular property taxes levied by a taxing district may not exceed 106 percent of the taxes levied by the district in the highest of the preceding 3 years. Added to this amount is the previous year's tax rate multiplied by the assessed value in the district that results from new construction and improvements to property in the previous year and any increase in the value of state-assessed property. To remove the incentive for a taxing district to maintain its tax levy at the maximum level permitted under the 106 percent limit, the Legislature in 1986 provided that the regular property tax levy for each taxing district, other than the state, could be set at the amount which would otherwise be allowed under the limit if the regular property tax levy for the district for taxes due in prior years beginning with 1986 had been set at the full amount allowed under the limit.

The 106 percent limit applies to the regular (non-voter-approved) levies of each property taxing district. This includes the state, counties, cities, port districts, fire protection districts, library districts, metropolitan park districts, public hospital districts, etc. The limit does not apply to excess (voter-approved) levies such as local school maintenance and operation levies and levies to retire bond issues.

Any levy by a taxing district in excess of the 106 percent limit requires voter approval. If such a levy is approved, it becomes the base for calculation of future levies, unless approved for only a limited time or purpose. A voter-approved levy of this type is not outside the restrictions of the 1 percent limitation. The approval is required by the Legislature for a taxing district to impose its regular levy to the extent that it exceeds the levy limit.

In a time of rapidly rising assessed values (roughly, if they grow faster than 6% per year), the effect of the 106 percent limit is to lower the tax rate of the district. As values rise, a lower rate will generate the same amount of taxes. If a taxing district imposed a tax at the same rate as the previous year, it would generate more revenues than the previous year. The 106 percent limit reduces the district’s tax rate to a rate that would generate only 6 percent more revenue. If assessed values are stable or growing slowly (less than 6% per year), a taxing district’s tax rate must increase each year to generate 6 percent more revenues than the previous year. When the district reaches its statutory rate limit, the tax rate cannot increase and the taxing district may collect less revenue each year. The 106 percent limit has no effect at these times.

The 106 percent limit does not limit the growth in assessed value of a parcel of property to 6 percent growth per year nor does it limit the growth in property taxes on a parcel of property to 6 percent per year. Since the property tax is based on assessed value multiplied by the tax rate, the tax is mostly dependent upon the increase in assessed value of the property, which is determined by the market. A taxing district’s rate may decrease but the tax on an individual taxpayer may increase if the assessed value of the taxpayer’s property increased.

Once the maximum allowable levy amount for a district is determined, the County Assessor calculates the regular property tax rate for the district by dividing the total levy amount by the amount of taxable property in the district. The following example illustrates the operation of the 106 percent limit on a taxing district and two parcels of residential property.

OPERATION OF THE 106% LIMIT

Taxing District	Year 1	Year 2	Change
Revenue Limit	$1,000,000	$1,000,000 x 1.06 = $1,060,000	6.0%
Total Assessed Value (AV)	$100,000,000	$107,500,000	7.5%
Tax Rate (per $1,000 AV)	$10.00	$9.86	(1.4%)

Residence A	Year 1	Year 2	Change
Assessed Value (AV)	$100,000	$110,000	10.0%
Tax Due (AV x Tax Rate)	$1,000	$1,085	8.5%

Residence B	Year 1	Year 2	Change
Assessed Value (AV)	$100,000	$105,000	5.0%
Tax Due (AV x Tax Rate)	$1,000	$1,035	3.5%

This example illustrates the operation of the 106 percent limit. In the first year, the taxing district's revenue limit is $1 million. With a total assessed value in the district of $100 million, the tax rate would equal $10 per $1,000 of assessed value. This would result in a tax of $1,000 on a residence assessed at $100,000. In the second year, the taxing district's revenue is limited to 106 percent of the previous year (or $1,060,000). Assuming that the total assessed value in the district has grown to $107.5 million, a tax rate of $9.86 would generate this amount of tax revenue. However, even though the taxing district's revenue grows by only 6 percent, the effect on individual parcels of property is different. Multiplying the new tax rate by the new valuation of a residence that grows in value by 10 percent (Residence A) results in an 8.5 percent increase in tax, while multiplying the new tax rate by the new valuation of a residence that grows in value by 5 percent (Residence B) results in a 3.5 percent increase in tax.

VI. PROPERTY TAX EXEMPTIONS

Article 7, section 1 of the state Constitution exempts all property of the United States and of the state, counties, school districts, and other municipal corporations. The Legislature is authorized (with certain restrictions) to exempt other property by general law. Major property tax exemptions that have been enacted by the Legislature include certain intangible personal property (money, mortgages, savings accounts, stocks, bonds, etc.), business inventories, household goods and personal effects, churches and their grounds, computer software, nonprofit hospitals, agricultural products, and private schools and colleges. In addition, Article 7, section 10 of the state Constitution authorizes residential property tax relief for retired property owners. The parameters of the program are set by the Legislature and are currently based on age and income. (See Senior Citizens, page 18.)

Tax exemptions lower the taxable value against which taxing districts levy their taxes. When exemptions are enacted, the tax rate of taxing districts that are not levying at their maximum statutory rate increase to compensate for the loss in value. Because of the higher rate, taxpayers who do not benefit from the exemption pay a higher tax. This higher tax is a shift of tax from the exempt taxpayer to the non-exempt taxpayer. To the extent that the tax rate of a taxing district cannot increase to compensate for the exemption, the taxing district generates less revenue than it otherwise would have.

The tax savings to taxpayers resulting from existing property tax exemptions for the 1995-97 biennium is estimated at $4.4 billion for state taxes and $14.9 billion for local taxes. This is in contrast to total projected property tax liability for the 1995-97 biennium of $2.2 billion for state taxes and $6.2 billion for local taxes. The following table illustrates the state and local tax savings to taxpayers from existing tax exemptions for the 1995-97 biennium.

Exemption	State Taxes	Local Taxes	Total
Intangible property (e.g. cash, deposits, loans, securities)	$2,922,168,000	$9,581,173,000	$12,503,341,000
Business inventories	$169,679,000	$661,045,000	$830,724,000
Household goods/personal effects	$95,452,000	$309,449,000	$404,901,000
Churches	$36,588,000	$118,668,000	$155,256,000
Senior citizens	$19,650,000	$124,620,000	$144,270,000
Computer software	$26,897,000	$96,858,000	$123,755,000
Nonprofit hospitals	$26,702,000	$84,610,000	$111,312,000
Agricultural products	$15,421,000	$55,532,000	$70,953,000
Private schools and colleges	$14,811,000	$48,046,000	$62,857,000
All others	$1,048,932,000	$3,854,399,000	$4,903,331,000
TOTAL	$4,376,300,000	$14,934,400,000	$19,310,700,000

VII. SENIOR CITIZENS

In 1966, the voters approved Article 7, section 10 of the state Constitution which authorized the Legislature to grant to retired property owners relief from the property tax on their principal residences. In 1967, the Legislature first granted property tax relief to senior citizens. Persons 65 years of age or older were entitled to property tax relief in the amount of $50 if their incomes were $3,000 or less per year. Under current law, persons at least 60 years of age and persons retired by reason of physical disability are entitled to some form of property tax relief on their principal residences if their incomes are $34,000 or less per year. For a history of the senior citizen property tax relief program, see Appendix D, page 45.

A. Summary

Persons are allowed to **defer** payment of their property taxes it they are 60 years of age or older or retired because of physical disability if their disposable household income is $34,000 or less. The deferral program generally applies to 1 acre of land but is increased to up to 5 acres of land if zoning requires this larger parcel size. An election to defer taxes is made in the year the taxes are due.

Additionally, if the person is at least 62 years of age or is retired due to physical disability with disposable household income of $28,000 or less, the person is also entitled to both a freeze on the value of the residence and a partial property **tax exemption**. Application can be made in the year the person reaches the age of 61. The valuation limit and exemption apply to the residence and up to 1 acre of land on which it is situated. Property tax relief is available for taxes payable in the year following the year of application, and thereafter.

The exemption and deferral programs apply to a residence that is occupied by the claimant at the time of filing. However, the exemption and deferral are still available if the residence is temporarily unoccupied or occupied by someone financially dependent on the claimant for support because the person is confined to a hospital or nursing home. In addition, rental of the residence to pay for hospital or nursing home costs does not disqualify the residence if the person is confined to a hospital or nursing home.

B. Disposable Household Income

Qualification for the senior citizen tax relief program is based on disposable household income. Disposable household income is the disposable income of the person claiming the exemption, the person's spouse, and any other person residing in the residence who has an ownership interest in the residence. If the person was retired for less than the entire year, but for at least two months, then an annual disposable income is calculated only from the retirement income. In addition, if a person's spouse dies during the year and the person's income is reduced for at least 2 months, or if substantial changes occur in disposable income that are likely to continue for an indefinite period, then annual disposable income is calculated from the retirement income after the occurrence.

Disposable income includes federal adjusted gross income plus the following if not already included: capital gains, deductions for loss, depreciation, pensions and annuities, military pay and benefits, veterans benefits, social security benefits, dividends, and interest income.

Excluded from disposable income are payments for the treatment or care of either spouse in the home or in a nursing home and expenditures for prescription drugs. Also excluded from disposable income are capital gains from the sale of a principal residence if 1) the gains are not subject to federal income tax because they are transferred to a new residence or 2) the gains are not subject to federal income tax under the one-time, $125,000 exclusion for senior citizens, but only to the extent the money is reinvested in a new principal residence.

C. Deferrals

A person who is at least 60 years of age or is retired from regular employment because of physical disability and whose disposable household income is $34,000 or less may defer payment of all property taxes and special benefit assessments imposed on the residence. An eligible person may defer any amounts due after taking any exemption to which the person may be entitled. An eligible person electing to defer taxes for any year must file a declaration to defer at least 30 days before the tax or assessment is due. Amounts deferred may accumulate up to 80 percent of the homeowner's equity and become a lien on the property in favor of the state. Upon death, change in use, or eventual sale of the property, the full amount of the deferred taxes and special benefit assessments is due, along with interest at 8 percent per year.

D. Valuation Limit - "Freeze"

A valuation freeze is available for a person at least 62 years of age or retired from regular employment because of physical disability with a disposable household income of $28,000 or less. Values are frozen as of January 1, 1995, or January 1 of the year the person first qualified for the program. The valuation can never exceed the market value. Failure to qualify for only 1 year because of high income does not change this valuation upon re-qualification. This valuation freeze does not transfer to a replacement residence. Subsequent improvements to the residence are added at market value.

A valuation freeze results in a taxable value that it less than it otherwise would be. In essence, this is an exemption of the increase in value of the property over the value of the property in the year of retirement. Like any other property tax exemption, the value freeze can result in tax shifts to other taxpayers and revenue losses to taxing districts.

E. Exemptions

A person at least 62 years of age or retired from regular employment because of physical disability with a disposable household income of $28,000 or less is completely exempt from paying excess property tax levies. Qualified persons with incomes below $18,000 also qualify for partial tax relief from regular property tax levies. Regular property tax levies do not require voter approval to be imposed. Like any other exemption, this partial exemption can result in tax shifts to other taxpayers and revenue losses to taxing districts.

The qualifying income limits and the exemptions associated with those incomes are summarized in the following table.

Income	Excess Levies	Regular Levies
$18,001 to $28,000	Exempt	No exemption
$15,001 to $18,000	Exempt	$30,000 or 30% of value exempt ($50,000 maximum)
$15,000 or less	Exempt	$34,000 or 50% of value exempt

F. Timing

The senior citizen property tax exemption program involves a two-year period. A person may make an initial claim with the County Assessor in the year in which the person reaches age 61. The income determination is based on an estimate of the income for that year. (This income is reported to the federal Internal Revenue Service on the tax return that is filed in the following year.) The exemption is effective for taxes due in the year following the year in which the claim is made. The following table illustrates this process.

Timing of Senior Citizen Property Tax Relief	
Calendar Year	**Activity**
1996	Income is received Apply for exemption to County Assessor during 1996 assessment year, using estimated calendar year 1996 income
1997	Taxes payable in 1997 are reduced File tax return for calendar year 1996 income with federal Internal Revenue Service

A renewal application must be filed every four years, but the County Assessor may require a renewal application following an amendment of the income requirements by the Legislature. Also, any person receiving an exemption is required to notify the County Assessor of any change in status affecting the person's entitlement to the exemption.

VIII. PROPERTY TAX POLICY

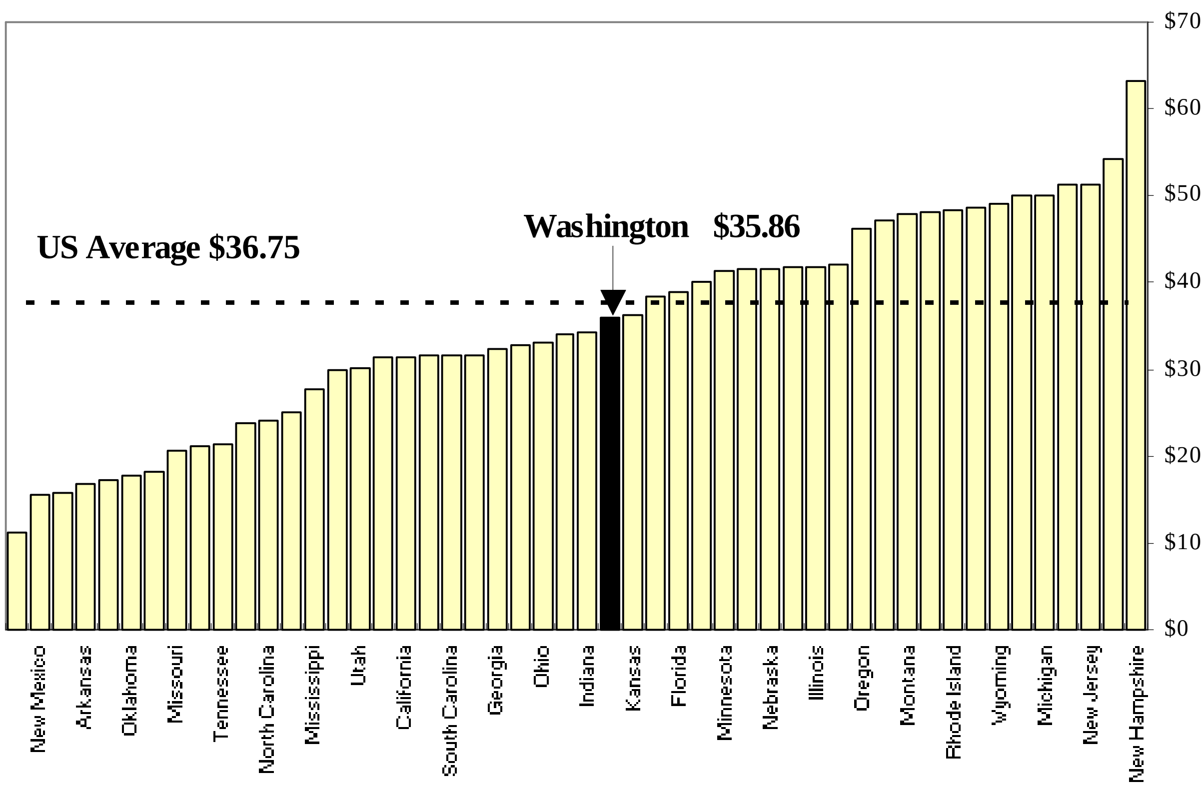
Property taxes have been, and will continue to be, a recurring issue for the Legislature. Numerous bills are introduced each session to address a variety of property tax issues. These bills range from minor adjustments in the current system to replacing the entire system and starting over. This section provides a national and historic perspective of the current property tax system. It then highlights some of the various concerns and approaches taken to address the concerns and is followed by a more detailed description of each type of legislative proposal.

A. Background

When compared to the other 49 states, state and local property taxes in Washington do not appear particularly high. For taxes due in 1993, Washington ranked 24th in property taxes at $35.26 per $1,000 of personal income. This is just below the national average of $36.75. Among the states without a personal income tax, only Nevada had lower property taxes than Washington.

Similarly, when calculated on a per capita basis, Washington ranked 21st, which again is near the average of all the states.

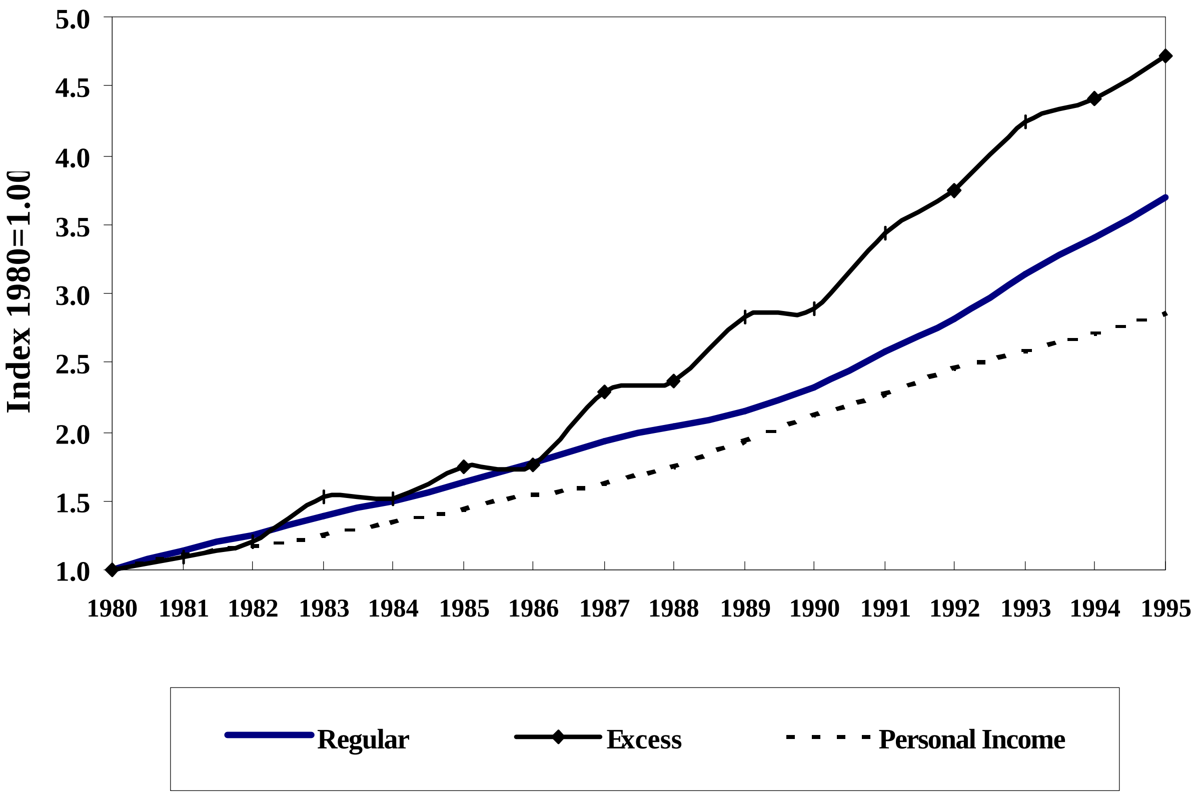
Property Taxes per $1000 of Personal Income
(By State - 1993)



When state and local property taxes are compared with personal income, another picture appears. As indicated by the graph below, the growth in property taxes since 1980 has been faster than statewide personal income growth. Property taxes are more than 3½ times higher in 1995 than in 1980, while personal income is only about 2½ times greater. This means that property taxes have required a higher percentage of a taxpayer's income each year since 1980 on the average.

Levies have grown for two primary reasons. First, property values have grown by 287.8 percent over this time period. Higher values with the same tax rate result in increased revenues, and the 106 percent limit allowed taxing districts to levy more tax each year. Second, voters have approved "excess" levies, which are not limited by either statutory rate limits or the 106 percent limit.

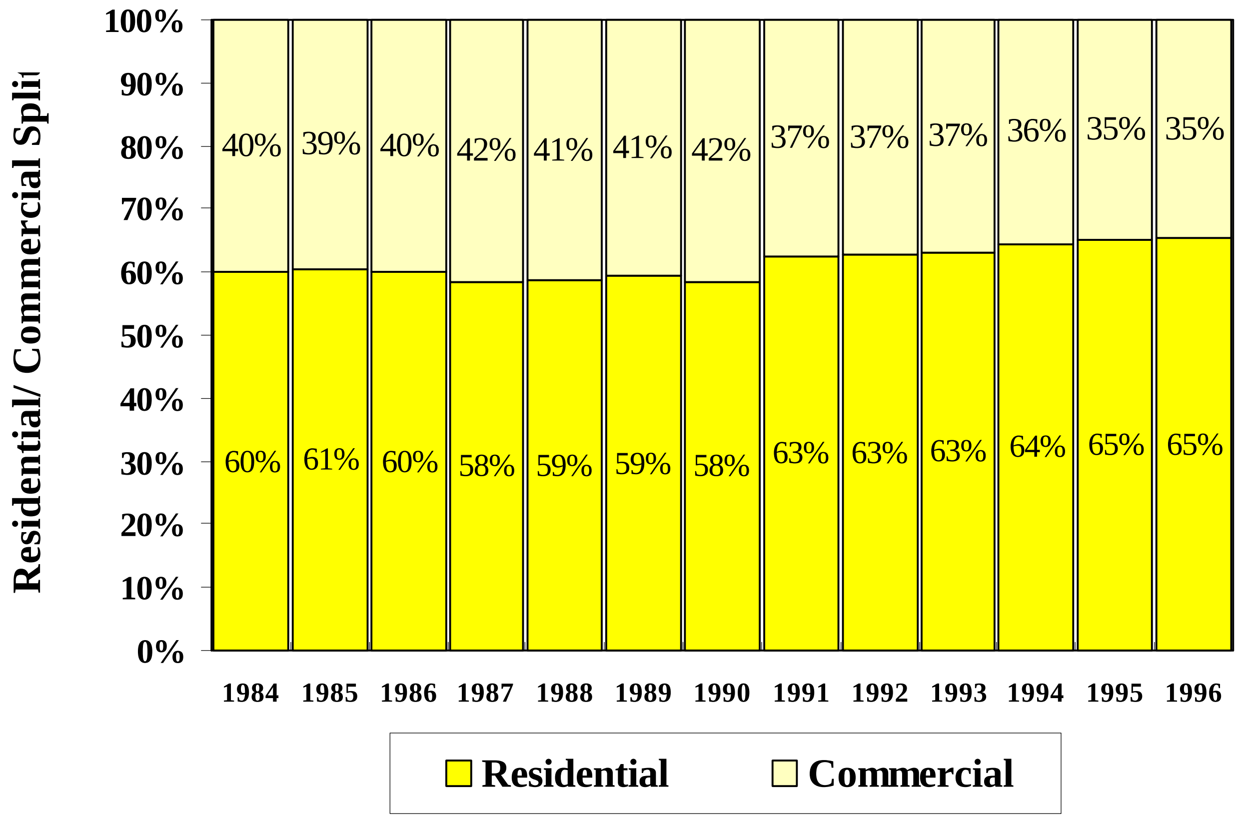
Statewide Property Tax Growth verses Personal Income Growth
1980 to 1995



Another important development in recent years is the change in the distribution of taxes between commercial property and residential property. Prior to 1991, commercial property comprised 42 percent of the assessed valuation in the state (and therefore 42 percent of the property tax liability) while residential property comprised the remaining 58 percent. Beginning in 1991, the tremendous real estate boom, especially in King County, caused this statewide relationship to change. Commercial property now comprises 35 percent of the assessed valuation in the state and residential property comprises the remaining 65 percent. Taxes on commercial property as a whole have decreased by 7 percent while taxes on residential property as a whole have increased by 7 percent.

There are two reasons for this shift of taxes from commercial property to residential property. One reason is that the booming real estate market of the early nineties drove the values of residential property up much faster than commercial property. Another reason is that there was a considerable amount of new residential construction at this time. The combination of these two trends has changed the split between commercial and residential property values and taxes.

Residential/Commercial Property Value Split (Statewide Average)



B. Typical Concerns Expressed about Property Taxes

The property tax is easily the most complex tax in the state of Washington. Any proposal that addresses one set of taxpayer's concerns is likely to affect other taxpayers elsewhere. Before solutions can be proposed, it is important to determine which concern is being addressed and what the secondary effects will be. Generally, concerns expressed about the property tax fall into one of the following categories:

1. The overall level of property tax is too high.
2. Residential property taxes are too high.
3. Taxes increase faster than a taxpayer's ability to pay.
4. Tax increases are unpredictable.
5. Tax increases create a risk that senior citizens and low-income persons will lose their homes.
6. Businesses are treated unfairly (being taxed on all intangible property).

C. Constitutional Considerations

Many of the bills introduced into the Legislature since 1989 have been accompanied by a constitutional amendment to authorize the change. Constitutional amendments may be necessary to implement multiple classification systems, valuation and tax limitations, homestead exemptions and credits, and extension of the senior citizen exemption program to low-income persons. This is because the state Constitution requires taxes to be uniform on the same class of property and further states that all real estate constitutes one class of property. Tax deferral proposals may violate the state constitutional provision prohibiting the lending of credit. Therefore, efforts to tax types of property differently raise constitutional issues.

However, constitutional amendments are not necessary to provide relief to senior citizens because the Constitution already grants to the Legislature the power to provide property tax relief on the residences of retired property owners.

A constitutional amendment is not necessary to reduce or eliminate the state levy, to modify the 106 percent limit, to require annual revaluations, to exempt intangible property, or to make miscellaneous administrative changes since these proposals would affect all property uniformly.

It should be noted that the state Supreme Court has held on numerous occasions that income is property and is subject to the uniformity clause. The Supreme Court first invalidated the graduated net income tax in *Culliton v. Chase*, 174 Wash 363 (1933). The court held that income was property because property included everything subject to ownership. The tax was therefore subject to the uniformity clause. The graduated features of the income tax violated uniformity because not all income was taxed at the same rate.

Therefore, it appears that any tax on income would be subject to the 1 percent limit. In combination, these constitutional provisions restrict any income tax to a flat rate of not more than 1 percent.

D. Effects on Taxpayers and Taxing Districts

When taxpayers receive a tax benefit in the form of a reduction in the value of property (such as from an exemption), two things can occur. First, taxes may be shifted from the taxpayer with the lower value onto all other taxpayers. This occurs only when taxing districts are able to recover the lost revenue by raising their tax rates to collect the same amount in total revenues because the district's tax rate is below the district's statutory rate limit. Second, when the taxing district reaches its statutory rate limit (for example, $3.60 in the case of the state portion of the property tax), any further reduction in value means that the district receives less in revenue. This occurs when there is no "rate capacity"remaining for the district to raise it's tax rate any higher.

E. "Splitting the Rolls" and Exempting Value

Traditionally, the term "split roll" in property taxation refers to a situation where property is separated by type and taxed differently, thereby requiring the assessor to maintain two or more tax rolls. For example, business properties could be valued at 100 percent of market value and residential properties valued at 75 percent. This would have the effect of shifting the tax burden away from residential properties and onto business properties. Because of the uniformity clause, traditional split rolls are not allowed in this state without a constitutional amendment.

However, there are programs very similar to split rolls in practice today. One example is the current use valuation program. Property in this program is valued based on the current use of the property (farmland, timberland, etc.) rather than the potential highest and best use of the property (shopping center, housing development, etc.). This reduces the assessed value of the property and shifts the taxes onto all other taxpayers. For taxes due in 1996, property in the current use program was taxed at 67.1% of the market value. Taxpayers received a tax benefit of $5.4 billion dollars, which was either shifted to other taxpayers or resulted in a revenue reduction for state and local taxing districts.

Another example is the senior citizen property tax exemption program. Senior citizens are able to pay property taxes on a reduced assessed value if they meet the age and income requirements of the program. All the taxes that would have been paid by participants in the program are paid by other taxpayers or result in taxing districts receiving less in revenue. For taxes due in 1996, 136,000 senior citizens received in the aggregate over $79 million in tax relief, with an average of $581 per participant.

There have also been various proposals, which are discussed in the next section, that can be considered to fall into this broad category of split rolls. A homestead exemption program would exempt a specific amount of residential property value ($50,000 for example) before taxes were calculated. Since the exemption would apply to only one type of property, it would shift the tax burden to others. Another example would be proposals to exempt all intangibles from property taxation. Since only businesses own intangible property that is currently taxable, the tax burden would shift to other types of property.

F. Legislative Proposals

The following table summarizes previous legislative proposals addressing the typical concerns expressed about the property tax and the impacts associated with the proposed solutions. A detailed explanation of the various proposals follows the table.

SUMMARY OF PREVIOUS PROPOSALS		
CONCERNS EXPRESSED	**SOLUTIONS PROPOSED**	**IMPACTS**
Overall level of taxes is too high	Reduce the state school levy	Reduction in GF revenues
	Reduce the 106% limit to inflation	Reduction in GF and local revenues
Residential property taxes are too high	Split Roll (non-uniform taxes)	Shifts tax burden to business properties
	Homestead Exemption	Shifts tax burden to business properties and to high-valued residential properties
	Residential Tax Credit	No shifts occur
Taxes increase too suddenly	Rolling Average Value Growth Limits	Shifts tax burden from properties with increasing values onto properties whose values grow more slowly
Senior homeowners are at risk of losing their homes	Senior Citizen Exemption Program	Shifts tax burden away from senior citizens and onto all others
	Senior Citizen Deferral Program	GF appropriation - No shifts occur
Businesses are treated unfairly (Intangibles)	Exempt ALL intangibles	Shifts tax burden from businesses whose taxes are based on intangible value onto all other taxpayers

1. Multiple Classification Systems ("Split Rolls")

In some states, property tax classification systems provide for one or more classes of property which are subject to different tax rates or valuations. For example, residential property could be classified separately from commercial or other property and taxed at a lower rate.

Another alternative is the two-tier property tax system where the land and improvements to land are taxed at different rates. If the tax rate on improvements is reduced to zero and the tax rate on the land increased to maintain revenues, the result is a land-value tax as proposed by Henry George in 1879. The difficulty with this system from an assessment standpoint is that land and improvements are sold as one unit which makes it difficult to separate out the value of the land.

Twenty-one states separate real property into classes, and fourteen states statutorily set residential property values at lower assessment levels than commercial and industrial property.

2. State Property Tax Levy Reduction or Elimination

There has been recent interest in reducing or eliminating the state property tax. In 1995, the Legislature enacted Senate Bill 5000 which provided a 4.7 percent reduction in the state property tax for 1996 taxes. House Bill 1022, providing an additional 5 percent reduction, was also enacted; however, it was vetoed by the Governor.

The state property tax constitutes 39.2 percent of regular property taxes and 25.4 percent of the total tax bill (for 1996 taxes). Reducing or eliminating the state property tax can result in 1) the provision of a relatively large amount of relief, 2) all taxpayers receiving relief, and 3) no reduction in local taxing district revenues.

In 1993, the Michigan Legislature eliminated the state property tax for the support of the common schools. The legislation did not replace the revenues. The Legislature subsequently referred to the voters a plan to replace the tax. The basis of the plan was an increase in the sales tax of 2 percent, but if rejected by the voters, the state income tax would automatically increase by 1.4 percent. The voters approved the sales tax increase. In Washington, state property tax revenue is forecast at $1,077 million for fiscal year 1996, which is equal to a sales tax rate of 1.6 percent.

3. Reducing the 106 Percent Limit

The 106 percent limit on property tax collections was adopted in 1971. The United States consumer price index (CPI) in 1970 was 5.9 percent, which may have had an effect on the choice of the limit. For the past few years, inflation has decreased to 3 percent while the 106 percent limit has not changed. In addition, because new construction is not included in the limit, the 106 percent limit actually allows increases of an average of 8 percent. Allowing increases to taxing district budgets of even 6 percent per year may appear unfair to taxpayers when taxpayers’ earnings are growing more slowly. Several bills have been introduced in the Legislature to lower the 106 percent limit to 103 percent or inflation, whichever is lower.

4. New Construction under the 106 Percent Limit

Added to 106 percent of a district's previous levy is an amount determined by multiplying the previous year's tax rate by the assessed value in the district resulting from new construction and improvements to property in the previous year and any increase in the assessed value of property assessed by the Department of Revenue (state-assessed property). In subsequent years, this is part of the base with which the 106 percent limit is calculated.

New construction is defined by rule of the Department of Revenue as the construction or alteration of property for which a building permit was or should have been issued and which results in an increase in the value of the property. Obviously, improvements to property and new construction can be the same thing and are treated similarly under the rules of the Department. Improvements to property include such things as putting a recreation room in an unfinished basement, adding a bathroom or den, putting on a new roof, and paving a driveway. Improvements to property do not include repairs which merely keep property in good operating condition, such as roof and driveway repairs.

New construction and improvements to property can add to service level requirements of taxing districts and therefore require higher taxes to be collected. However, increases in state-assessed property value may not. When the Department of Revenue values utility and transportation companies, it generally uses the income and cost approaches which do not indicate whether or not the value resulted from an improvement to property. While adding state-assessed property value increases to the 106 percent limit is a bonus to taxing districts, it is an accommodation to the manner in which state-assessed property is valued.

5. Valuation Increase Limits

In recent years, legislation has been proposed which would: 1) allow the revaluation of real property only on sale of the property, 2) limit valuation increases to a certain percentage, usually with the exception that property can be revalued up to market value on sale, or 3) limit real property valuation increases to the lesser of inflation or a fixed percentage. A provision may also be added that rolls back valuation levels to a previous date.

These proposals are similar to Proposition 13 in California. Enacted in 1978, Proposition 13 rolled property values back to their 1975 levels, limited property valuation increases to 2 percent per year (except on sale of the property), and limited property taxes to 1 percent of value. Upon sale of the property, the property is revalued up to fair market value. This system is an acquisition-value system and was upheld by the United States Supreme Court against an equal protection challenge in *Nordlinger v. Hahn*, 112 S. Ct. 2326 (1992). In *Nordlinger*, the court held that the equal protection clause only required the classification scheme to rationally further a legitimate state interest. The court stated that the scheme rationally furthered two legitimate state interests. The first was discouraging rapid turnover in ownership of homes and businesses to foster local neighborhood preservation, continuity, and stability. The second was that a new owner did not have the same reliance interest warranting protection against higher taxes as an existing owner who doesn't have the option of deciding not to buy if taxes become prohibitively high.

It should be noted that while the standards used by Washington courts in applying the uniformity clause appear similar to an analysis under the equal protection clause of the United States Constitution, the uniformity clause is, generally speaking, substantially more restrictive than the equal protection clause.

"[S]omewhat stringent provisions of state constitutions as to equality of taxation on all kinds of property which left but little room for classification ... have much embarrassed state legislatures because actual equality of taxation is unobtainable. ... The reports of this Court are full of cases which demonstrate that the Fourteenth Amendment was not intended, and is not to be construed as having such object as these stiff and unyielding requirements of equality in state constitutions." *Puget Sound Power & Light Co. v.*

King County, 264 U.S. 22 (1923). Under equal protection analysis, there is no violation if there is a rational basis for the difference in treatment. However, there is no rational basis exception to the uniformity requirement of Article 7, section 1 of the state Constitution. The only discrepancies in uniformity that will be tolerated are those required by the practical necessities of revaluing property when the program is carried out "in an orderly manner and pursuant to a regular plan, and if it is not done in an arbitrary, capricious or intentionally discriminatory manner". *Sator v. Department of Revenue*, 89 Wn. 2d 338 (1977).

Proposition 13 had the effect of lowering property taxes in California by 57 percent and reducing local revenues overall by 52 percent. To compensate, other taxes have been increased, most notably the graduated income tax. In addition, there have been increases in charges for municipal services.

According to a 1990 report from the California Senate Office of Research, there is a disparity between market value and assessed value in the state. The report concluded that the property tax does not provide equal treatment to property owners if equity is measured by the benefits received by the taxpayer.

In 1992, the Florida voters adopted a “Save our Homes” initiative which limited assessed value increases on homesteads to the lesser of inflation or 3 percent, except on sale.

Under an acquisition-value system (like Proposition 13), property taxes would tend to shift:

- From property which has increased MORE in value to property which has increased LESS in value since the rollback date;
- From LONG-TERM homeowners to NEW homeowners; and
- From REAL to PERSONAL property.

6. Phase-in of Valuation Increases

Legislation has been introduced requiring a phase-in or an averaging of value increases onto the tax rolls. Under these proposals, valuation increases are either added to the tax rolls over a period of years or a rolling average of values is added to the tax rolls. Each of these scenarios results in a short-term reduction in the taxable value over what the taxable values would otherwise have been.

Whenever values are reduced, tax rates rise to compensate for the loss to the extent that taxing districts are not at their statutory dollar rate limit. This is especially true of voter-approved levies which are approved for a certain amount of money per year, and the rates are set based on the total assessed value. This results in taxes begin shifted to those taxpayers who do not benefit from the limitation on value increases.

7. Current Use Valuation for All Property

Legislation has been introduced to require current use valuation for all property rather than highest and best use valuation. For most property, the current use value is the same as the highest and best use value. The property that would be most affected by a change to current use valuation is residential and undeveloped property that is in areas in transition from primarily residential to primarily commercial. Taxes would be shifted from those properties benefiting from a lower value onto properties whose values are not changed.

8. Annual Revaluations

Counties that are on revaluation cycles that are longer than two years do not statistically adjust the value of property between revaluations. As a result, the change in value for an individual parcel of property follows a stair-step pattern. For example, in a four-year revaluation cycle there is no change in value for a parcel of property for three years. In the fourth year, there could be a substantial change in value representing four years of value growth.

Requiring annual revaluations of property reduces or eliminates large increases in assessed valuation. Many people like the 3-year free ride under the 4-year cycle. On the other hand, annual revaluations require a greater commitment of resources at the county level, and the change in valuation in the county may be so gradual as not to justify annual revaluations.

9. Senior Citizen and Low-income Exemptions

Because Article 7, section 10 of the state Constitution authorizes property tax relief for retired property owners, the Legislature has great flexibility in providing relief to retired property owners. In 1995, the Legislature provided a valuation freeze for senior citizens and persons retired because of physical disability. In addition, the upper eligibility income limit was raised from $26,000 to $28,000 for the exemption program and from $30,000 to $34,000 for the deferral program. The income eligibility limit for the maximum exemption ($15,000) and the valuation exempted at that income level ($34,000 or 50% of valuation) has not been increased since 1991 (for 1992 taxes). Some senior citizens who previously were completely exempt from tax are now beginning to pay some tax because of 1) large valuation increases on their residences or 2) ineligibility resulting from inflation adjustments to their pension incomes.

Bills have been introduced that would expand the senior citizen tax exemption program to all low-income persons. This may require a constitutional amendment.

10. Homestead Exemptions and Credits

Homestead exemptions and credits apply to owner-occupied residential property. Homestead exemptions reduce the assessed value of a homeowner's property. Alternatively, homestead credits are amounts subtracted from the tax owed. Thirty-seven states offer homestead exemptions or credits: Fourteen states and the District of Columbia have programs with no age limits, fourteen states have programs for seniors only, and nine states offer programs for all ages with more generous benefits for senior citizens.

A homestead exemption shifts taxes to higher-valued residential property and to commercial property. A homestead credit does not shift taxes to other taxpayers but results in a decrease in revenues to taxing districts. Any homestead exemption that is limited to owner-occupied residential property would require an application procedure and monitoring requirements. While an exemption or credit for all residential property would not impose this administrative requirement, rental property would also be eligible for the property tax relief.

11. Exemptions for Intangible Property

All property in this state is subject to the property tax each year based on the property's value unless a specific exemption is provided by law. The state Constitution defines "property" for tax purposes as "everything, whether tangible or intangible, subject to ownership."

A major exemption from the property tax exists for some intangible property. Intangible property is property that has no physical substance and is not susceptible to being perceived by the senses. Exempt intangibles include: money, mortgages, notes, accounts, certificates of deposit, tax certificates, judgments, government bonds and warrants, stocks and shares of private corporations, private nongovernmental personal service contracts, and private nongovernmental athletic or sports franchises.

Other types of intangible property are taxable, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, non-compete agreements, customer lists, and business goodwill. For property assessed by the Department of Revenue, standard appraisal practices tend to capture intangible value. For locally assessed property, intangible value, when it exists, may be included in the real property value when the income approach or the comparable sales approach is used. Intangible value will also be included when businesses expressly report intangible personal property on their personal property affidavits.

While intangible "attributes," such as location, zoning, or view, often affect the market value of real or tangible personal property, these attributes are not intangible "property" but are merely characteristics that buyers and sellers use in determining the market value of property. In contrast, intangible property can be bought and sold completely independently of other property. Therefore, an exemption of all intangibles would not include the exemption of these attributes. For example, under an exemption for intangibles, a business may no longer pay taxes on the value of its trademarks but would continue to pay taxes on the value of having a good business location.

In the late 1980's, the Department of Revenue was sued by Burlington Northern on the grounds that the company was being discriminated against. The taxpayer believed that local values did not include intangible value because counties often rely on the cost approach for valuations. The court stated that the cost approach has a factor for entrepreneurial profit which does incorporate intangibles. The court also found that appraisal methods used by county assessors sometimes captured intangible assets of local businesses but that often intangible assets were overlooked. The remedy for the underassessment of local property due to this oversight was through an adjustment of the assessment ratio. The taxpayer was entitled to relief only if the underassessment caused its assessment ratio to be higher than that of locally assessed property.

As a result, the Department, as part of the state school levy equalization process, decreased the assessment ratios for many counties because of the failure to tax intangibles. (See Equalization of Assessments, page 8). This caused the state portion of the property tax to increase in those counties.

At the same time, Congress allowed "goodwill" to be listed as a depreciable asset for federal income tax purposes. This made it more likely that businesses would show goodwill on their books and that assessors would tend to tax it. The combination of falling ratios and the ability to find goodwill on the books of businesses led some assessors to assess the value of previously unassessed intangible property. Businesses began to complain about the assessment (and taxation) of previously untaxed property. Businesses also feared that assessors would begin to further tax these and other intangibles.

The Department responded with a letter in January 1996 advising county assessors not to ask for a separate reporting of intangibles on the personal property affidavit as these values would often already be included in the market value of real property. This had the effect of eliminating the possibility that these businesses could be double taxed. However, intangible property remained taxable. In 1996, bills were introduced in the Legislature to exempt all intangibles from taxation, but none of these bills were enacted by the Legislature.

12. Tax Increase Limits

Legislation has been introduced to limit the tax increases on residential property to various percentages. Some proposals allow property to be revalued to up market value on sale. These bills are usually limited to owner-occupied residential property. Any limit that applies to residential property that is owner-occupied would require an application procedure and monitoring requirements.

13. Tax Deferrals

Sixteen states and the District of Columbia offer deferral programs that allow certain people, usually the elderly and disabled, to postpone paying property taxes until death or the sale of their property. The programs in fourteen states (including Washington) are limited to persons over a certain age.

Legislation has been introduced in Washington 1) to provide a tax deferral for property tax increases over a certain percentage, 2) to defer taxes over a certain percentage of combined disposable income, sometimes with a cap on the total amount subject to deferral, and 3) to defer taxes over a certain percentage of income if it is less than a certain amount. These proposals are generally patterned after the senior citizen property tax deferral program and require an application procedure and monitoring requirements. This approach lessens the possibility that taxpayers would lose their homes because of rising taxes. Other taxpayers are unaffected because taxes do not shift to other taxpayers. For those bills patterned after the senior citizen tax deferral program, local taxing districts are also unaffected because the state reimburses the districts for their deferred taxes. However, the cost of the program can be large in the initial years because the state reimburses local taxing districts. Since the program is a deferral and not an exemption, the taxes are recovered over time.

Senior citizens with incomes of $28,000 or less are eligible for the senior citizen property tax exemption program, and 136,000 senior citizens use the program. Senior citizens with incomes of $34,000 or less are eligible for the senior citizen property tax deferral program. Of the approximately 150,000 persons eligible, only 1,500 use the program. Many senior citizens seem reluctant to defer taxes. Younger persons may not have the same attitude, and people may have a different attitude if the deferral program is presented as an equity loan rather than a lien. However, it is clear that only a small percentage of those persons eligible for the current program currently use it.

14. Administrative

Bills have been introduced to provide additional information on revaluation notices and tax statements, to have tax statements sent to the property owner as well as the person paying the tax, to prohibit an increase in valuation during an administrative appeals to an amount greater than the valuation placed upon the property by the county assessor, and to require cities to notify assessors when action they take could affect land values.

Bills have also been introduced to eliminate the hardship of paying taxes twice a year. These bills have authorized quarterly or monthly payments. Many people pay property taxes on a twelve-month schedule through their mortgage lenders because 1) the lender requires monthly payments into a reserve fund or 2) the borrower voluntarily elects to pay into a reserve fund. While authorizing more frequent payments would help persons who own their own homes or who are purchasing on contract, these persons could voluntarily set up a reserve fund or finance the taxes and make periodic payments to the lender.

APPENDIX A: MAJOR CHANGES IN THE PROPERTY TAX

1889 State Constitution adopted. Property to be taxed in proportion to its value. The Legislature must provide a uniform rate of assessment and taxation according to its value in money. The Legislature may grant exemptions.

1899 Amendment 3 (approved 1900). Personal property tax exemption of $300 per household enacted.

1925 Exemption enacted for certain intangible personal property (mortgages, notes, certificates of deposit, etc.).

1929 Amendment 14 (approved 1930). All taxes on the same class of property to be uniform, and real estate is one class. (Current uniformity clause.) A yield tax on reforestation lands and mines is allowed.

1931 Timber on <u>reforestation</u> lands exempt from property tax but subject to a yield tax. Reforestation land statutorily valued at $1-2 per acre.

1932 Taxes limited to 40 mills (4¢) per dollar of assessed value. Assessment at 50 percent of true and fair value required. (This is equivalent to a limit of 2 percent of true and fair value.)

1935 Exemption for all household goods and personal effects enacted.

1937 Exemption for motor vehicles enacted.

1943 Amendment 17 (approved 1944). Taxes limited to 40 mills (4¢) per dollar of assessed value. Assessment at 50 percent of true and fair value required. (This is equivalent to a limit of 2 percent of true and fair value.) Levies in excess of the limit are authorized if approved by 60 percent of the voters at an election at which the number voting equals at least 40 percent of those voting in the last general election. Excess levies limited to 1 except for capital levies.

1955 Four-year revaluation cycle adopted.

1965 Amendment 47 (approved 1966). Property tax relief authorized for residential property of retired persons. (For a history of this program, see Appendix D, page 45.)

1967 Amendment 53 (approved 1968). Current use valuation authorized for open space, agricultural, and timber lands.

1970 Current use valuation program for open space, agricultural, and timber lands enacted.

1971 Amendment 59 (approved 1972). Taxes limited to 1 percent of true and fair value. 40 percent voter turnout requirement for operating levies changed to requirement that the "yes" vote constitute 60 percent of a number equal to 40 percent of the number of votes cast in the last general election (i.e. 24 percent of the number of votes cast). Timber on <u>all</u> lands exempt from property tax but subject to a yield tax. New forest land valuation program enacted providing current use valuation of the land. Regular property tax levies of local taxing districts limited to 106 percent of prior levies (effective with 1974 collections).

1972 Residential improvements up to 30% of value exempt for 3 years.

1973 Assessment levels statutorily increased from 50 percent to 100 percent for 1975 collections.

1974 Exemption enacted for business inventories, effective 1984, with a business and occupation tax credit equal to 10 percent of the property taxes paid on business inventories in 1974 increasing to 100 percent of the property taxes paid on business inventories in 1983.

1976 Amendment 64. Two-year excess levies for school districts authorized.

1979 State levy subject to the 106 percent limit.

1982 Physical inspection requirement on revaluation extended to 6 years if the assessor statistically updates values annually.

1983 Privately owned timber on public lands subject to property tax. Credit against timber excise (yield) tax authorized for property taxes paid on timber.

1988 Personal property tax exemption for heads of households increased from $300 to $3,000.

1986 Amendment 79. School district levies for construction, modernization, or remodeling of school facilities may be for up to 6 years.

1995 State levy reduced by 4.7 percent for 1996 collections only.

APPENDIX B: CURRENT USE PROGRAMS

The state Constitution authorizes agricultural, timber, and open space land to be valued on the basis of their current use rather than fair market value. Current use valuation reduces the taxable value against which taxing districts levy their taxes. When values are lowered, the tax rate of taxing districts that are not levying at their maximum statutory rate increases to compensate for the lower value. Because of the higher rate, taxpayers who do not benefit from the valuation reduction pay a higher tax. This higher tax is a shift of tax from the property valued at current use to property valued at highest and best use. To the extent that the tax rate of a taxing district cannot increase to compensate for the loss in value, the taxing district generates less revenue than it otherwise would have generated.

Two programs currently implement this constitutional exception to fair market value: the "open space" program and the "forest land" program. There are three categories of land under the open space program: 1) open space lands, 2) farm and agricultural lands, and 3) timber lands. There are two categories of land under the forest land program: classified and designated forest land.

A. Open Space Program

Open space land is any land designated as such by an official comprehensive land use plan and any land area, the preservation of which in its present use would:

- Conserve and enhance natural or scenic resources;
- Protect streams or water supply;
- Promote conservation of soils, wetlands, beaches, or tidal marshes;
- Enhance the value to the public of abutting or neighboring parks, forests, wildlife preserves, nature reservations or sanctuaries, or other open space;
- Enhance recreation opportunities;
- Preserve historic sites;
- Preserve visual quality along highway, road, and street corridors or scenic vistas; or
- Retain in its natural state tracts of land not less than one acre situated in an urban area and open to public use on such conditions as may be reasonably required by the legislative body granting the open space classification.

Open space land is valued based on the use to which the property is currently applied rather than other potential uses. The value must be at least the minimum value per acre of classified farm and agricultural land.

Farm and agricultural lands must be devoted primarily to commercial agricultural purposes. To qualify for classification as farm and agricultural land, the land must meet income tests for 3 of the previous 5 years. For classified farm and agricultural land for which an application was made before January 1, 1993, and that has not been transferred to a new owner since January 1, 1993, farm parcels of less than 5 acres must generate $1,000 in farm gross income and farm parcels of less than 20 acres and greater than 5 acres must generate $100 per acre. For classified farm and agricultural land for which an application is made after January 1, 1993, farm parcels less than 5 acres must generate $1,500 in farm gross income and farm parcels less than 20 acres and greater than 5 acres must generate $200 per acre. Farm parcels greater than 20 acres have no income test.

The income test for farm land less than 20 acres is deferred for 5 years when the land is reclassified into farm and agricultural land from timber land or farm and agricultural conservation land under the open space program or from the forest land categories under the forest land program.

The value for farm and agricultural land is determined by discounting the “net cash rental” of comparable farm lands growing crops typical to the area. Net cash rental is the average rent paid in cash or its equivalent. The discount rate is the rate of interest charged on long-term farm loans plus a component for property taxes.

Land under farm dwellings is assessed at farmland values. This treatment applies only to farms over 20 acres when use of the dwelling is integral to farm operation. The current use value of land under farm dwellings is set at the average farm and agricultural land value plus the value of land improvements for septic, water, and power to serve the residence.

In addition, open space land includes farm and agricultural conservation land which are those lands formerly classified as farm and agricultural lands that no longer meet the income test or are not being actively farmed.

Timber land is land of 5 or more acres devoted primarily to the growing and harvesting of timber. Timber land is valued under the forest land program (see page 38) and is based on the value of the bare land for growing and harvesting timber.

Applications for classification as farm and agricultural land are made to the County Assessor. A denial by the assessor can be appealed to the county Board of Equalization. Applications for open space or timber land are made to the county legislative authority. Appeals of county legislative authority decisions are made to the Superior Court.

Property may be removed from open space classification by the owner giving notice to withdraw. Land is removed from open space classification by the assessor if it no longer is used for the purpose under which it was granted open space classification.

When property is removed from open space classification, back taxes plus interest must be paid. The back taxes represent the tax benefit received over the most recent seven years plus interest on the taxes from the time they would have been paid if the land were not assessed at current use. The interest rate is the rate payable on delinquent property taxes, which is 12 percent per year. In addition, a penalty equal to 20 percent of the back taxes and interest is applied. The penalty may be avoided if the property remains in the program for at least 10 years and a two-year waiting period after notice of withdrawal is satisfied. Back taxes are not charged when land under farm dwellings is removed from classification. Back taxes are also not paid if the land is removed because of:

- A transfer to a government entity in exchange for other land;
- A transfer through the exercise of eminent domain or the threat of eminent domain;
- Natural disaster;
- Official action which disallows the present use of such land;
- A transfer to a church; or

- Transfer to a governmental entity or nonprofit historic preservation or nonprofit nature conservancy corporation for the purpose of conserving open space land.

Certain transfers between classifications are allowed without payment of back taxes. Open space land may not be transferred into another classification, except that the farm and agricultural conservation land category of open space land may be transferred to farm and agricultural land if the land had been previously classified as farm and agricultural land. Farm and agricultural land may be transferred into any other category of open space land or forest land. Timber land may be transferred into any other category of open space land or forest land.

Sale or transfer to a new owner triggers removal from the open space program unless the transfer occurs due to inheritance. Back taxes must be paid unless the new owner signs an agreement to continue in the program.

B. Forest Land Program

Land which has no higher and better use than growing and harvesting timber may be classified as forest land by the County Assessor. Land which is used to grow and harvest timber but which is more valuable for other uses may be designated as forest land by the assessor upon application to the County Assessor by the landowner. To qualify for either, the land must be 20 acres or more and be used primarily for growing and harvesting timber. The valuation of classified and designated forest land is set by statute and is based on the value of the bare land for growing and harvesting timber. The values vary based on the grade and operability of the land and are adjusted annually by the Department of Revenue. For 1994, the values ranged from a low of $17 per acre to a high of $201 per acre.

Land is removed from classification or designation:

- At the request of the owner;
- By sale or transfer to an ownership making the land exempt from tax;
- By sale or transfer of the land to a new owner, unless the new owner signs a notice of classification continuance; and
- For classified land, by a determination that the land is no longer primarily used for growing and harvesting timber or that a better use exists for the land than growing and harvesting timber.

Upon removal from classification, both classified and designated forest land may be subject to a compensating tax. The tax is equal to the tax benefit in the most recent year multiplied by the number of years the land was classified or designated, not to exceed ten. Interest is due only if the tax is not paid within 30 days after notification of the tax. The compensating tax is distributed to taxing districts in the same manner as other taxes imposed in the year in which the compensating tax is due.

The compensating tax is not imposed if the removal resulted from the following:

- A transfer to a government entity in exchange for other forest land in Washington;
- A taking by or transfer under threat of eminent domain,
- Sale or transfer of fee title to the Parks and Recreation Commission for park purposes.

- A donation of fee title, development rights, or the right to harvest timber, to a government agency or nonprofit historic preservation or nature conservancy corporation for the purpose of limiting the future use of the land; or
- The sale or transfer to a governmental entity or nonprofit nature conservancy corporation for conservation purposes of land recommended for state natural area preserve purposes by the natural heritage council. However, if the land is later used for any other purpose, the compensating tax is imposed upon the current owner.

Certain transfers between classifications are allowed without payment of compensating taxes. Classified forest land may be transferred into any other category of open space land or forest land. Designated forest land may be transferred into any other category of open space land but not to classified forest land.

C. Transfers Among Classifications Summarized

Transfers without payment of back taxes can be made between all categories of current use classifications except for transfers out of open space. However, land classified as farm and agricultural conservation land within open space may be transferred to the farm and agricultural land category.

D. Back Tax Payment Exceptions Compared Between Programs

The exceptions to the payment of back taxes are slightly different for the open space program and the forest land program. For example, an exception is allowed under the open space program if government action no longer permits the present use of the property. The forest land program does not have this exception.

In the open space program, an exception to the payment of back taxes is allowed for a sale or transfer to a governmental entity or nonprofit historic preservation or nonprofit nature conservancy corporation for the purpose of conserving open space land. However, in the forest land category, the similar exception is much more restrictive. The forest land exception is restricted to a sale or transfer to a governmental entity or nonprofit nature conservancy corporation for conservation purposes of land recommended for state natural area preserve purposes by the Natural Heritage Council.

Finally, the forest land program has an exception for transfers to the Parks and Recreation Commission for park purposes. The open space program does not have this exception.

E. Comparison of "Open Space Timber" and "Forest" Land

The open space program for timber land and the forest land program are basically the same. They differ in the minimum acreage requirements and the application process. Application is made to the County Assessor for forest land and to the county legislative authority for open space timber land. A timber management plan must be filed in each case, and the reasons for denial of the application are the same.

When land is removed from classification, back taxes are due. For open space timber land, the tax is equal to the tax benefit received over the most recent seven years plus interest on the taxes from the time they would have been paid if the land were not assessed at current use. In addition, a penalty equal to 20 percent of the back taxes and interest may be applied. For forest land under the forest land program, the tax is equal to the tax benefit in the most recent year multiplied by the number of years the land was classified or designated, not to exceed ten. Interest is due only if the tax is not paid within 30 days after notification of the tax.

APPENDIX C: UNIFORMITY OF ASSESSMENTS - 1889 TO THE PRESENT

This section examines the requirements of the state Constitution with respect to the assessment of property taxes, with particular emphasis on the concepts of uniformity and fair market value. A chronological approach is taken to describe the evolution of Washington's current case law in light of the constitutional limitations existing at the time of the decisions.

1889-1929: Uniform Taxation in Proportion to Value

The original text of Article 7, section 1 of the state Constitution provided that "all property shall be taxed in proportion to its value, to be ascertained as provided by law." Article 7, section 2 required the Legislature to provide by law "a uniform and equal rate of assessment and taxation on all property in the state, according to its value in money."

In *Kinnear v. King Co.*, 124 Wash. 102 (1923), the property of the taxpayer was assessed at twice its true and fair value. At that time, statutes required assessments to be at 50 percent of true and fair value. The taxpayer alleged that the uniformity clause was violated. The state Supreme Court upheld the assessment because there was no evidence that similar properties were not treated similarly. "If property, even if over-valued, is assessed in the same proportion as other like property ..., and the system of valuation adopted operates equally on all other property, the constitutional provision as to uniformity of taxation is complied with."

1930-1943: Modern Uniformity Clause

In 1930, Article 7, sections 1 and 2 were repealed and a new section was adopted (Amendment 14). The new section 1 provided that (1) all taxes on the same class of property shall be uniform within the territorial limits of the authority levying the tax and (2) real estate constitutes one class. This uniformity clause remains unchanged in the present state Constitution.

In 1932, property was valued and assessed by the County Assessor. Independently, property was reassessed by the State Tax Commission. These new assessments were certified to the county for use in the levy of local taxes. *State ex rel. State Tax Commission v. Redd*, 166 Wash. 132 (1932), involved the valuation of property that had been disputed by the taxpayer. The taxpayer had appealed the valuation to the superior court which set a valuation between the taxpayer's value and the assessor's value. Subsequently, the State Tax Commission reassessed the property and certified the value to the county. The certified value was higher than the court's value. The assessor refused to use the new value, and the State Tax Commission sued for a writ of mandate. The state Supreme Court ruled that Article 11, section 12, which prohibits the state from imposing local taxes, prevented the state from reassessing for <u>local</u> taxation purposes. Equalization of property for local purposes was a proper function of the county board of equalization, not the state.

In discussing the equalization process for the state levy, the court said the state could place one value on property for state purposes and another value for county purposes.

In discussing the unit system of valuation of intercounty railroads and the apportionment of value between counties by miles of track, the court said "Uniformity and equality in all respects can never be exactly attained, and all that legislation has hitherto been able to accomplish, or perhaps ever will be able to achieve, is to approximate that end" (quoting a Colorado case). The assessment of property does not violate the uniformity clause "so long as such property is charged by the same rate of levy and its assessed value measured by the same standard as other property within the state."

1944-1971: 40 Mill Limit - Assessment at 50% of Value

In 1944, Article 7, section 2 (Amendment 17) was adopted limiting taxes on property to 40 mills (4¢) per dollar of assessed value "which assessed valuation shall be fifty per centum of the true and fair value of such property in money." This was equivalent to a 2 percent limit on true and fair value.

In 1956, RCW 84.41.030 was adopted requiring all county assessors to revalue all property in the county by 1958 and to thereafter maintain a 4-year cycle. The various county assessors did not fully comply with the statute. In 1966, the average assessment ratio for all property in King county was 23.7 percent. As a result, in 1969 the Legislature appropriated funds to county assessors for a systematic 4-year revaluation.

In 1969, King county was revaluing by ranges and townships on a 6-7 year cycle and Snohomish county was revaluing by school district on a 4-year cycle. Values were posted in the year of assessment. Statutes required property to be assessed at 50 percent of its true and fair value and required true and fair value to be at time of assessment. King county appraised on a "long-run" value as opposed to an immediate sale value. Generally property was underassessed in all counties.

In *Carkonen v. Williams*, 76 Wn. 2d 617 (1969), taxpayers alleged a lack of uniformity in a bicounty school district because of differing assessments, the 4-year cyclical revaluation program, and use of a different appraisal method than required by statute. The state Supreme Court held that assessment at 50 percent of true and fair value as required by the Constitution and the statutes was mandatory. The court also held that the authority levying the school district tax was the county and therefor the taxes were uniform within the territorial limits of the authority levying the tax.

The court also upheld the 4-year cyclical revaluation program against the uniformity challenge. The assessments would violate of the uniformity clause only if they constituted intentional discrimination, arbitrary action, constructive fraud, or grossly unequal valuations. The court cited a U.S. Supreme Court case upholding property tax valuations as representing "an honest effort in new and difficult circumstances to adopt valuations not relatively unjust or unequal." The court also noted that efforts were underway by the Legislature, the assessors, and the Department of Revenue "which can lead to substantial improvements in valuation schedules and the maintenance of greater uniformity and equality in the future."

The court held that use of a long-run value was contrary to the <u>statutory</u> provision prohibiting use of a different standard of value.

In 1971, the Legislature enacted legislation which allowed assessors to deduct from the valuation the reasonable cost of sale. In *State ex rel. Morgan v. Kinnear*, 80 Wn. 2d 400 (1972), the state Supreme Court invalidated the legislation, holding that true and fair value meant market value and citing a long line of cases.

Also in 1971, the 4-year revaluation cycle was again challenged. King county had instituted a comprehensive 4-year revaluation cycle. In the first year, only 6 percent of the property was revalued. In *Dore v. Kinnear*, 79 Wn. 2d. 755 (1971), the state Supreme Court held that a systematic and consistent program of revaluation must be maintained during each year of a cyclical revaluation cycle. Reappraisal of only 6 percent of the property, done with knowledge, is inherently arbitrary and capricious. Gross variations in the 4-year cycle are not permitted, the court held.

In *Morrison v. Rutherford*, 83 Wn. 2d 153 (1973), another taxpayer challenged the 4-year cycle because the taxpayer's property was assessed at a value 100 percent higher than the identical adjoining property which was not revalued in the same year. The state Supreme Court held that substantial disparities do not, per se, violate the uniformity clause. It must be shown that the method of assessment was arbitrary, capricious, or intentionally discriminatory. The taxes were upheld because the revaluation was "conducted orderly and pursuant to a regular plan."

In implementing the 4-year revaluation program, property assessed in the first year of the cycle was valued much higher than other property because of the generally low assessed values existing at the time. This caused a shift of taxes to the newly revalued property. In 1971, the Legislature enacted legislation limiting the assessments placed on revalued property. The legislation provided for a comparison of the ratio of all property in the county to true and fair value with the ratio of revalued property to true and fair value. If the revaluation ratio exceeded 110 percent of the county ratio, revalued values were to be rolled back to equal the county ratio. This rollback statute was challenged as violating Amendment 14 (uniformity clause) and Amendment 17 (assessment at 50 percent of true and fair value) in *Snohomish County Bd. of Equalization v. Department of Revenue*, 80 Wn. 2d 262, 264 (1972). The state Supreme Court held the rollback statute valid on the basis that it "does no more than provide for an equitable transition to the required constitutional standard without discrimination and inequality within each county." The court reaffirmed *Carkonen*, stating that assessment at 50 percent of true and fair value is mandatory under the Constitution. After expiration of the 4-year cycle, no further deviation would be tolerated.

The rollback statute was effective May 21, 1971. The 1970 assessment year was the first year of Pierce county's new 4-year cycle. The state Supreme Court held in *Valentine v. Johnston*, 83 Wn. 2d 390 (1974), that the rollback statute should be applied retroactively (to 1970 assessments for 1971 taxes) so that the program was systematic and without discrimination.

In *Bitney v. Morgan*, 84 Wn. 2d 9 (1974), owners of dairy farms in King county alleged violation of the uniformity clause because their farms were valued on the basis of comparable sales, while farms in eastern Washington were valued using the income method. Taxpayers argued that an income approach should be used because land speculation drove up comparable sale prices. The court held that Article 7, section 2, which required property to be assessed at 50 percent of true and fair value, implied market value prevailing at the time of assessment. The court said that different methods can be used in different regions based on different considerations affecting the fair market value of the properties.

1972-present: Modern 1% Limitation

In 1972, Article 7, section 2 was amended to limit taxes to 1 percent of true and fair value instead of 2 percent (Amendments 55 & 59). The phrase "which assessed valuation shall be fifty per centum of the true and fair value of such property in money" was eliminated.

In *Sator v. Department of Revenue*, 89 Wn. 2d 338 (1977), taxpayers challenged the state school levy and state equalization procedure under the new 1 percent limit. The state Supreme Court held that "there is now no constitutional requirement that property be assessed at 100 percent of true and fair value. The constitutional requirement is only that aggregate levies not exceed 1 percent of true and fair value." The questions to be asked were whether the total tax exceeds 1 percent of true and fair value and whether the taxpayers were treated uniformly with other taxpayers in their class.

The court upheld the 4-year revaluation cycle. Incidental inequalities may result from the cycle, but it does not violate the uniformity clause because it is conducted in an orderly manner and pursuant to a regular plan, and it is not done in an arbitrary, capricious, or intentionally discriminatory manner. "A program is not invalid just because it is imperfect; minor discrepancies will be tolerated in an otherwise acceptable statewide system."

"Absolute uniformity in taxation is a chimera which this court has never sought and which we do not require. The Legislature has set up an orderly system for revaluation. This system, based on a rational view of the practical realities of budgets, public acceptance and basic fairness has been accepted by this court as a systematic and nondiscriminatory solution to the demands of Const. Art. 7, § 1 (Amendment 14). If the system is administered in a systematic, nondiscriminatory manner, ... it will be upheld as meeting the test of amendment 14. Appellants may believe that there is a better method of solving the problem of property taxation or a better system, but the forum in which to press that view is the Legislature, not the courts."

"There is nothing in the constitution that requires each class of property--real and personal--to be assessed at 100 percent of true or fair value or, indeed, assessed at any figure. The only requirement is that each person within the class be treated uniformly. ... Due process and equal protection require that classifications for purposes of taxation have a reasonable basis and not be arbitrary and capricious."

APPENDIX D: HISTORY OF THE SENIOR CITIZEN PROPERTY TAX EXEMPTION

1966 Constitution amended to allow property tax relief to retired homeowners.

1967 Senior citizen exemption set at $50, must live in residence for 5 years or 1 year if a 10-year resident, be 65 if male and 62 if female, and have combined income of ≤ $3,000.

1971 $50 senior citizen exemption replaced by exemption from special levies: Income of ≤ $4,000 = 100% exemption; income from $4,001 to $6,000 = 50% exemption. Must live in residence 2 years or 1 year if a 3-year resident. Exemption limited to 1 acre.

1972 Residence must only be occupied on January 1st if a 3-year resident. Mobile homes added. Only 2/3 of social security income counted.

1973 Only 2/3 of federal civil service retirement and railroad retirement pensions counted.

1974 For special levies, income ≤ $5,000 = 100% exempt; $5,001 to $6,000 = 50% exempt; for regular levies, incomes ≤ $4,000 exempt on first $5,000 of residential value.

1975 Senior citizens with income ≤ $8,000 may defer taxes. Income indexed after 1976.

1977 Senior citizen exemption income limits increased by $2,000.

1979 Households with incomes ≤ $11,000 exempt from all special levies; those with incomes ≤ $7,000 exempt from regular levies on first $15,000 value of residence. Eligibility for occupying residence for 2 years and 3-year resident requirement removed. Life estates added. Surviving spouse qualifies if 57 years old. Confinement to a nursing home does not disqualify.

1980 Disposable income defined. 1/3 exclusion for social security is eliminated, but income levels are increased by $3,000 to $14,000 for special levies and to $10,000 for regular levies; leases for life added.

1983 For 1984, maximum income increased to $15,000, regular levy residential value exemption increased to $20,000; starting in 1985, two-step regular levy exemption depending upon income: If income is $9,001 to $12,000, exemption = $20,000 or 30% of valuation, not to exceed $40,000; if income is ≤ $9,000, exemption = $25,000 or 50% of valuation. Nursing home care costs and military & veteran benefit payments for attendant-care medical-aid not counted. One-time application instituted.

1984 Uniform eligibility requirements established for senior citizen exemption and deferral programs.

1987 For 1989, maximum income increased to $18,000; Regular levy valuation exemption amounts increased: if income is $12,001 to $14,000, exemption = $24,000 or 30% of valuation, not to exceed $40,000; if income is ≤ $12,000, exemption = $28,000 or 50% of valuation.

1991 For 1991, eligible income level for deferral increased to $30,000. For 1992, maximum income for exemption increased to $26,000; Regular levy valuation exemption amounts increased: if income is $15,001 to $18,000, exemption = $30,000 or 30% of valuation, not to exceed $50,000; if income is ≤ $15,000, exemption = $34,000 or 50% of valuation. Capital gains from the sale of the residence and in-home care expenses excluded from income determination.

1992 Income verification required. Renewal applications required every 4 years and may be required by assessors upon change in income limits. Disposable income of person widowed in preceding year based on retirement income after death of spouse.

1993 Exemption not lost if the residence is rented for the purposes of paying hospital or nursing home costs.

1995 For 1996, eligible income for exemption increased to $28,000 and prescription drug costs are deductible. Use of current year income instead of preceding year income. Valuation is frozen at the assessed value on January 1, 1995, or January 1 of the year the person first qualifies. Eligible income for deferral program is increased to $34,000 and taxes on up to 5 acres may be deferred.